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Dellaportas, Steven, Yapa, P.W. Senarath and Sivanantham, Sivakaran 2008, Internationalising auditing standards : stakeholder views on Australia's strategic directions, *Managerial auditing journal*, vol. 23, no. 7, pp. 663-684.

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# Internationalising auditing standards: stakeholder views on Australia's strategic directions

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**Purpose** – The purpose of this paper is to examine and evaluate the internationalisation of Australian auditing standards by analysing the submissions to the Auditing and Assurance Standards Board's (AUASB) strategic directions paper (SDP) and comparing the proposed and approved strategic directions frameworks of the AUASB.

**Design/methodology/approach** – A content analysis of the submissions to the SDP is conducted to identify the extent of support, and arguments for and against the proposed strategic directions. This study attempts to find a link, if any, between the proposed strategic directions, the views expressed by the stakeholders, and the final set of strategic directions issued by Australia's Financial Reporting Council.

**Findings** – Overall, the final set of strategic directions released in April 2005 are consistent with the views expressed in the submissions, which support minimal divergence from International Standards on Auditing (ISAs) and using the ISAs as the base for developing Australian auditing standards. Major changes from the SDP include a requirement for the AUASB to undertake research and monitor auditing standards issued by national standard setters. However, the AUASB is no longer obliged to contribute to the international standard arena and need only have regard to any program initiated by the International Auditing and Assurance Standards Board.

**Research limitations/implications** – The findings of this study provide an insight into the future of Australia's role in the international arena and increase awareness of stakeholders' views on the international harmonisation of auditing standards.

**Originality/value** – While there have been several studies examining the international harmonisation of accounting standards, there is comparatively little research on the international harmonisation of auditing standards. This paper attempts to address this void, in part, and contribute to the literature on the convergence of auditing standards with ISAs.

**Keyword(s):** International standards; Auditing standards; Strategic evaluation; Australia.

## Introduction

Major corporate scandals, such as Enron and Worldcom in the USA, Paramalat in Europe and HIH Group of Companies (HIH) and One.Tel Australia, have led to debate concerning the aim and scope of auditing. With the publication of the Ramsay (2001) Report on *Independence of Australian Company Auditors* and the HIH Royal Commission (Owen, 2003)[1], the debate in Australia centred on the independence of company auditors. As part of the regulatory reforms that followed this debate, the Australian Government enacted the Corporate Law Economic Reform Program (Audit Reform and Disclosure) Act 2004 (CLERP 9 Act 2004) on July 1, 2004, which brought substantial changes to the Australian corporate reporting and disclosure landscape. The Financial Reporting Council (FRC), established on January 1, 2000 with responsibility for the broad oversight of the accounting standard setting process, had its responsibilities expanded to include the oversight of the auditing standard process as well as monitoring the effectiveness of auditor independence requirements in Australia. The Auditing and Assurance Standards Board (AUASB) was simultaneously reconstituted as a new statutory body responsible for setting auditing standards[2]. The AUASB, previously under the auspices of the accounting profession, now reports to the FRC. One major task of the newly reconstituted AUASB was to engage in redrafting existing auditing standards to ensure their enforceability under the Corporations Act 2001. While the legal backing afforded to accounting

standards existed for some years, it was not until the furore over the collapse of companies like HIH and One.Tel that the impetus arose to remove the standard setting process from the profession and make audit standards legally enforceable. Consequently, the self-regulatory model in which the accounting profession was responsible for developing auditing standards is now replaced with a statutory model in which auditing standards have the force of law under the Corporations Act 2001. With such changes, auditing has assumed an increased regulatory significance and can now be considered part of the broader governance framework that influences Australia's financial reporting system.

In preparation for the transition to the new auditing standard setting arrangements, the FRC established a taskforce to consider the future strategic direction of the AUASB (FRC, 2004). In October 2004, upon the advent of its new oversight responsibility, the FRC issued the AUASB's strategic directions paper (SDP) with an invitation to interested parties to comment on the AUASB's strategic direction (FRC, 2004). The FRC sought comments on two key issues relating to the internationalisation of auditing standards, namely:

1. the appropriateness of basing Australian auditing standards on the standards issued by the International Auditing and Assurance Standards Board (IAASB); and
2. whether the AUASB should have regard to, or adopt, standards developed by other international auditing standard setting bodies.

Recognising the significance of having high-quality auditing practices in Australia, the purpose of this paper is to explore the issues associated with the internationalisation of Australian auditing standards, with a particular focus on evaluating the views expressed by interested parties in their submissions to the SDP proposed by the FRC for the newly reconstituted AUASB. This paper will also examine the changes in the AUASB's strategic directions by comparing the proposed strategic directions in the SDP with the final set of approved strategic directions, and the extent to which such changes reflect the views put forward in the stakeholder submissions.

The remainder of this paper is structured as follows. The next section briefly explores the issues associated with international harmonisation which relies on an examination of the literature of accounting standards given the dearth of research on the international harmonisation of auditing standards. This section also examines the auditing standard regime in Australia to determine the extent of Australia's commitment to international standards of auditing prior to the issue of the SDP. Such an examination provides a base to assess the extent to which the FRC's strategic directions for setting auditing standards have altered the standard setting regime in Australia. The third section describes the data collection process and the method of analysis which relies on a textual analysis of the submissions to the SDP. The fourth section analyses the submissions to draw inferences or key themes arising from the data to determine the issues and the extent of support for internationalising Australian auditing standards. The fifth section examines the strategic directions approved by the FRC by comparing them to the strategic directions proposed in the SDP and then analysing and discussing the differences. The sixth and final section concludes the paper with an evaluation of the extent to which the AUASB's strategic directions has changed with the release of the approved strategic directions.

### **The harmonisation debate**

The phrase "international harmonisation" has been widely discussed and debated in the accounting literature with little attention, if any, afforded to auditing standards[3]. In spite of the intrinsic link between accounting and auditing practice, research on the international harmonisation of auditing standards has received comparatively little attention. Consequently, this paper relies on the accounting literature to highlight the major issues associated with international harmonisation. The increasing globalisation of world economies and business practices highlighted the limitations associated with country-specific accounting standards and the problems created by the diversity of trans-national accounting practices. Financial reports prepared using country-specific accounting standards lack international comparability which in turn restricts cross-national capital flows and the development of global capital markets. Consequently, critics of country-specific accounting standards have called for the international harmonisation of accounting standards to reduce the diversity of trans-national accounting practices so that it may develop integrated capital markets, which in turn will

reduce the cost preparing financial reports, reduce information risk, and lower the cost of capital to listed companies (Choi and Levich, 1990; Australian Accounting Research Foundation – AARF, 1994; Rahman *et al.*, 1994; Carlson, 1997; Saudagaran and Meek, 1997; Buchanan, 2003; Alfredson *et al.*, 2005).

Australia's commitment to international harmonisation is evidenced by its adoption of the International Financial Reporting Standards (IFRS)[4] issued by the International Accounting Standards Board (IASB) as the basis for promulgating Australian Accounting Standards, known as Australian equivalents to IFRS – AIFRS. However, Australian accounting standards had been recognised internationally as high-quality standards and the case for Australian reform had not been adequately developed (Collet *et al.*, 1998; Stoddart, 2000), particularly when IASs are broad in design to meet the needs of many countries with diverse information needs (Street and Shaughnessy, 1998). Furthermore, accounting standards set internationally may not cater for the range of national circumstances, legal systems, stages of economic development and cultural differences (Samuels and Piper, 1985; Tarca, 1998). Some authors question Australia's rationale for adopting IASs particularly when the adoption of IFRS had support from a limited number of proponents (the ASX, its members and the IASB) and received strong opposition to from the business community, the accounting profession, and members of academe (Brown and Tarca, 2001; Collet *et al.*, 1998; Stoddart, 2000). Collet *et al.* (1998) question the adoption of IASs in light of the apparent influence of the major listed corporations and the ASX, who are arguably the main beneficiaries of the Australian accounting harmonisation process. Stoddart (2000) similarly argues that the structural change to the accounting standard setting process was an exercise of opportunistic behaviour by the Australian Government to demonstrate its credibility in the territory of corporate law.

In spite of the issues associated with the harmonisation of accounting standards, international harmonisation is now firmly embedded in Australia's system of financial reporting. However, at a time when one might expect the internationalisation debate to settle, the adoption of IFRSs in Australia has created momentum in the process of internationalisation that now calls for the international harmonisation of Australian auditing standards, which according to Weetman (2006), is the next major area of globalisation now that the IFRS are firmly embedded. Dzinkowski (2006) predicts that the momentum created by the process of harmonisation will eventually expand to the convergence of international regulatory bodies. While there have been several studies examining the international harmonisation of accounting standards, which were discussed only briefly in this paper, there is comparatively little research on the international harmonisation of auditing standards (Weetman, 2006)[5]. Consequently, there is a void in the literature on the international harmonisation of auditing standards. This paper attempts to address this void and contribute to the literature on international harmonisation and the convergence of auditing standards[6].

In order to better understand the potential implications of the AUASBs SDP, this paper examines the former AuASB's policy on internationalising auditing standards. The AuASB existed as a board of the AARF, which was jointly controlled and funded by Australia's two major professional accounting bodies, The Institute of Chartered Accountants in Australia (ICAA) and CPA Australia. Guidance in developing auditing standards was provided in the former AUS 102 *Foreword to Australian Auditing and Assurance Standards and Guidance Statements*, last issued in January 2002 which predated the release of the SDP in 2004[7]. This standard set out the structure and authority of auditing pronouncements, as well as the due process employed by the AuASB prior to the implementation of the amendments encased in the CLERP 9 Act 2004. Paragraph 14 of AUS 102 demonstrated AuASBs commitment to internationalisation by stating that the AuASB must endeavour to ensure that the Australian auditing pronouncements are issued to cover the topics addressed in International Standards on Auditing (ISAs). Paragraph 16 further enhanced this commitment by stating that the responsibility of the AuASB is to ensure that compliance with Australian standards also constituted compliance with ISAs. Australia's commitment to convergence with ISAs prior to the FRC issuing its SDP is demonstrated in AUS 102, which strongly encouraged consistency and compliance with ISAs. This sentiment is echoed by the FRC (2004) when it stated that the former AuASB had a long-standing policy of convergence and harmonisation of Australian auditing standards with ISAs issued by the IAASB. The AuASB demonstrated its commitment to convergence by synchronising its work plan with the IAASB to be able to contribute positively, thus permitting Australia to provide input to the IAASB prior to the development and release of ISAs (FRC, 2004). The extent to which the stakeholder views, submitted in response to the SDP, differ from this sentiment will be explored and analysed below.

## Research method

This paper examines and evaluates the internationalisation of Australian auditing standards in light of the FRC's proposed strategic directions and the recent Australian accounting harmonisation experience. The primary research question will be investigated by conducting a content analysis of the submissions to the SDP to identify the extent and basis of support for the proposed strategic directions. This study attempts to find a link, if any, between the FRC's proposed directions for the AUASB, the views expressed by the interested stakeholders, and the final set of strategic directions approved by the FRC. The findings in this study will provide valuable insight into the current Australian auditing environment and increase awareness of stakeholders' views on the international harmonisation of Australian auditing standards. Further, the findings will provide insight into the views of the respondents about the future of the Australian auditing standard setting process and Australia's role in the international standard setting arena.

The SDP was issued by the FRC with an invitation to interested parties to comment. About 23 submissions were received by the FRC, but one submission was declared confidential leaving 22 submissions available for content analysis[8]. The submissions, received from various organisations and individuals, were grouped into five broad categories according to the nature and function of the contributor (Table I). The categories include audit firms or organisations (further divided into Big 4, non-Big 4 firms and the Association for Auditors General), professional associations (divided into accounting and non-accounting associations)[9], preparers of financial reports, regulators and academe.

The majority of submissions (10) were received from audit firms. This is not surprising since changes to the audit regime, if any, are likely to have a direct impact on audit firms and their operations. Significant changes to existing auditing standards, if any, could incur significant costs with re-educating auditors, academics and deskilling existing auditors. Understanding the interests of the Big 4 audit firms (PriceWaterhouseCoopers, Deloitte, Ernst & Young and KPMG) is critical since they audit the majority of the larger ASX listed companies and consequently form a significant part of the Australian audit industry. The non-Big 4 audit firms generally focus on providing services to Australia's middle market and smaller clients. Examining the views of non-Big 4 accounting firms is useful to determine whether the views differ from other stakeholders, particularly the Big 4 audit firms.

The next largest cohort of submissions (7) comprises professional associations which include Australia's major accounting associations. Historically, the two major professional accounting associations in Australia (CPA Australia and ICAA), through the AARF, were dominant in determining auditing standards and practices. However, the enactment of the CLERP 9 Act 2004 and the federal government's apparent loss of confidence in the accounting profession to develop standards in the public interest, means that the professional accounting bodies have a diffused role in the promulgation of auditing standards. Thus, it is of particular interest that this paper reveals their position and views on setting the strategic directions for Australia's peak audit standard setting body. The remaining three categories include representations from preparers of financial reports (2); regulators (2); and academe (2). While the submissions from these groups are comparatively small, they display a representation from a wider stakeholder group.

The respondents were asked to address five questions listed in the SDP entitled "Matters for Consideration" (Table II) which subsequently form the criteria by which the submissions were analysed in this paper. These questions centre on the two key themes relating to internationalisation raised earlier in this paper:

1. the appropriateness of basing Australian auditing standards on the standards issued by the IAASB (Questions 1-3); and
2. whether the AUASB should have regard to, or adopt, standards developed by other international auditing standard setting bodies (Questions 4 and 5).

This paper relies on a content analysis of the submissions to the SDP to draw inferences from the messages sent by the stakeholders via their submissions. A content analysis of the submissions will determine the extent of support for internationalising Australian auditing standards and the issues as observed by the stakeholders. A research approach relying on content analysis involves an element

of subjectivity when interpreting messages (Carney, 1972). However, subjectivity in this paper is minimised with submissions explicitly responding, either positively or negatively, to specific matters or considerations raised in the SDP.

## Research findings

*RQ1.* Should the objective of having the highest quality auditing standards take precedence over an objective of having minimal divergence from ISA, particularly given the role of auditing standards in the broader governance framework and the need to ensure standards have regard to the public interest?

The majority of respondents, 68 percent, disagreed with the question indicating that minimal divergence from ISAs is the preferred method to achieving highest quality auditing standards (Table III). Consequently, respondents feel that highest quality auditing standards and convergence with ISAs are not mutually exclusive. A number of respondents, including the audit firms and the professional accounting associations, argue that the best quality standards are those that are internationally recognised and thus Australia's efforts should be focused on the standards developed by the IAASB. Some respondents linked the internationalisation of auditing standards with the internationalisation of accounting standards indicating that the adoption international auditing standards is inevitable with the acceptance of IFRs in Australia. For example, the ACAG (a society of auditors general) stated that with the recent convergence of IFRSs in Australia, it would be a logical step for Australia to adopt the ISAs as the local standard. Grant Thornton (non-Big 4 audit firm) similarly claimed that this approach will assist in maintaining international consistency and comparability of financial reporting. The SIA (an association for financial services) argued that the same broad approach that the FRC adopted to develop accounting standards should be adopted for the AUASB. The NIA (accounting association) emphasised the impact of convergence on capital market efficiency and confidence in the globalisation of capital markets.

Some respondents went further than mere convergence and supported the adoption of ISAs in their entirety. Deloitte, KPMG, and PKF argued that Australia should adopt ISAs without amendment. In particular, KPMG (Big 4 audit firm) stated that: "... the AUASB should embark on a process of adopting ISA's as Australian Auditing Standards word for word." Such an approach promotes consistency with internationally accepted standards which are readily acceptable in global capital markets. PKF (non-Big 4 audit firm) acknowledge the practical implications of fully adopting ISAs, highlighting the benefit of releasing resources for other projects: "... the adoption of ISAs will avoid reinventing the wheel and free up AUASB resources for the preparation of advice and guidance on the application of the standards."

According to KPMG (Big 4 audit firm), the challenge for the Australian standard setter is not to create a higher quality auditing standard but to contribute to the efforts of IAASB to create globally accepted, high-quality standards. KPMG states that Australia must be in a position to make effective contributions to the development of a single set of uniform auditing standards for world-wide use. Consequently, KPMG calls for the AUASB to continue to support the activities of the IAASB and take a leading and more active role in the international standard setting arena. SIA similarly claims that the public interest is better served by Australia's full participation in the international standard setting arena. The NIA states that the AUASB should be doing more than just rubber stamp ISAs:

It should be an Australian focus for thinking on auditing standards globally and in Australia, and needs to ensure that Australia plays an international role.

Overall, there was general consensus among the submissions to base Australian auditing standards on ISAs. The professional accounting associations have committed considerable financial resources and intellectual capital to the ISAs. Thus, Australia should make the most of this infrastructure. However, the full adoption of ISAs means that the AUASB would be dependent on the work of the IAASB and problems may arise when the ISAs lack relevance to the Australian environment. Furthermore, such standards may undermine the Australian standard setting expertise.

Contrary to the majority view, 23 percent (five respondents) favoured highest quality auditing standards in Australia over convergence with ISAs. They espoused the view that highest quality auditing standards with a strong public interest focus should take precedence over the objective of minimal divergence. According to Australian Securities and Investments Commission (ASIC) (national regulator), the CLERP 9 auditing standard setting initiatives were intended to change the standard setting focus to a public interest/statutory model, rather than a continuation of the professional/self-regulatory approach. Even though ASIC acknowledged that IFAC and the IAASB have recently implemented a number of strategies to address quality and public interest issues, ASIC was critical that the ISAs are not developed independently from the profession. Consequently, auditing standards will continue to be developed by the profession with the *locus* of power merely shifting from a national setting to the international arena. Thus, in ASIC's view, a strict ISA adoption policy is contrary to the rationale behind the CLERP 9 changes:

RQ2. Should the AUASB follow the approach of its predecessor and continue to use ISA as a basis for developing and making Australian auditing standards?

The submissions that supported minimal divergence from ISAs generally supported the adoption of ISAs as the basis for developing Australian auditing standards. In responding to this question, 64 (14 submissions) suggested that the newly reconstituted AUASB should follow its predecessor's approach and continue to base its standards on ISAs (Table III). As with question one of the "Matters for Consideration," the respondents to question two generally linked their arguments to the internationalisation of accounting standards, claiming that adopting ISAs is a logical consequence of adopting international accounting standards. However, this recommendation was not without reservation. ASIC (national regulator) initially recommended the development of auditing standards from first principles, which would involve developing auditing standards from zero base. However, ASIC also acknowledged that this approach may be impractical and therefore offered its support for using ISAs as a minimum basis. Pitcher Partners, as an advocate for the mid-tier audit firms, expressed concerns that auditing standards are primarily aimed at stakeholders in capital markets, and the needs of middle market and non-listed entities have been overshadowed by the needs of capital markets. This argument is echoed in the literature on the international harmonisation of accounting standards, whereby the process of harmonisation is driven by political and market pressures:

RQ3. Does the "clarity of standards" project undertaken by the IAASB impose any time constraints on the ability of Australia using current ISA as a basis for developing and making auditing standards?

The majority of respondents (59 percent) did not believe that the "Clarity of Standards Project" undertaken by the IAASB would impose time constraints on the AUASB's ability to use ISAs for developing Australian auditing standards<sup>[10]</sup> (Table III). According to this view, amendments can be incorporated into existing standards as and when finalised. ASIC (national regulator) and the G100 (association of CFOs) stated that waiting for this project was inappropriate, arguing that the clarity project will not be complete for many years and it will result in a two-tier set of ISAs for some time<sup>[11]</sup>. ASIC criticised the clarity project, claiming that by proposing to undertake this project, the IAASB acknowledges that the existing ISAs are deficient. Consequently, ASIC questions the appropriateness of using ISAs as the basis for Australian auditing standards.

Four respondents (18 percent) expressed concerns about the potential impacts of the clarity project on the timing of Australian auditing standards. CPA Australia (accounting association) stated: "the AUASB will be forced to rewrite the standards with greater clarity before the IAASB, merely because of ill-timing." Similar views were expressed by PwC and KPMG (Big 4 audit firms), stating that the AUASB should work along side the European standard setting bodies and the IAASB to set a timetable that satisfies the needs of all jurisdictions. CPA Australia suggested that the revision of ISAs will affect the current deadline and may need to be extended in line with the timetable set by the EU. However, ACAG (a society of auditors general) stated that the clarity of standards project should not be perceived as interfering with the current strategy, but rather as an additional responsibility of the AUASB for monitoring the work of this task force and taking into account their findings. To this end, the AUASB must now revisit auditing standards that were restructured for their legal enforceability, so that they now comply with the amendments resulting from the clarity project:

*RQ4.* Should the AUASB have regard to, or even adopt, auditing standards made by standard setters other than the IAASB – such as the US PCAOB – when developing and making best practice auditing standards for Australia?

About 18 percent (four submissions) favoured the consideration of auditing standards developed by “other” standard setters but supported the adoption of such standards only if necessary (Table III). The remaining submissions similarly indicated that it would be useful for the AUASB to have regard to auditing standards developed by other leading standard setters around the world but did not support the adoption of such standards. The respondents’ view on this issue was clear, they favoured the consideration of standards developed by “other” national standard setters but they expressed reservations about the adoption of such standards. Similar to the arguments that arose in the debate on the internationalisation of accounting standards, auditing standards developed from national jurisdictions that are particular to an environment, may not produce standards relevant to the Australian context. For example, CPA Australia (accounting association) stated that auditing standards based on a variety of jurisdictions will result in non compliance and non-acceptance with particular jurisdictions. Similarly, the AICD (preparer) stated that:

[...] the practical effect of such a standard will depend on the system of law in the originating jurisdiction and may have different effects in another jurisdiction.

Swindells DK (non-Big 4 audit firm), states:

[...] we shall not tie our country to any particular single jurisdiction. The ISAs are developed with the same approach that Australia needs, so we should align ourselves with the ISA standard setting process.

According to the ASA (investor association):

Australia should attempt to try and be entirely consistent with one international standard setter. [By] having an approach that arbitrarily selects which body's standards the Australian standards will be harmonised with, has the potential to confuse retail investors.

Deloitte (Big audit firm) and the ASA noted that:

[...] it will be easier to explain that we follow internationally accepted standards for both accounting and auditing than to explain we follow the US in one arena and international standards in another.

Overall, reducing differences between national auditing standards through the adoption of ISAs, is the preferred approach to the convergence of auditing standards.

Some submissions were particularly critical of adopting auditing standards developed by the PCAOB, regarded as one of two major standard setters (IAASB and PCAOB) (Simnett, 2007). Deloitte (Big 4 audit firm) argued that the PCAOB has been established in response to the market conditions in the USA. Thus, its standards will inevitably reflect the US legislative requirements, which have not been adopted by most other jurisdictions around the world. Additionally, Deloitte stated that these requirements apply only to public companies while the Australian auditing standards apply to all audits. Grant Thornton (non-Big 4 audit firm) similarly argues that the PCAOB standards apply to listed companies and therefore they may prejudice smaller companies. Further, it was argued that PCAOB standards are extensively rules-based and they are not subject to the same due process or international scrutiny as the ISAs:

*RQ5.* Are there any problems posed by adopting rules-based standards within a predominant principles-based standards regime and how should these be best addressed?

The majority of respondents (68 percent) believed that rules-based standards would not enhance audit quality and the implementation of rules-based standards is problematic within a principles-based regime (Table III). The respondents believed that principle-based standards are preferable and it was neither appropriate nor necessary to adopt auditing standards developed under a rules-based system.

Two respondents (ASIC – regulator and The Institute of Internal Auditors Australia (IIAA) – association of internal auditors) held the view that developing auditing standards from first principles would be in Australia's best interest because it will lead to improved audit practices in Australia and avoid potential problems raised by rules-based standards.

A number of respondents such as CPA Australia, ICAA (accounting associations), Ernst & Young, Grant Thornton (audit firms), referred to the major corporate collapses in the USA and claimed that they collapsed in part because of the rules-based accounting and auditing standards adopted in the USA. Both the ICAA and CPA Australia opposed such a move, suggesting the structure of existing standards does not require change. The audit firms argue that rules-based standards have not been broadly adopted outside of the USA in either accounting or auditing. Furthermore, Ernst & Young believed that adopting a mixed approach (mix of principle-based and rules-based) would lead to serious potential implications, such as significant delays in the development of auditing standards, diluting the clarity of the standard setting framework, and confusing auditors in interpreting and applying the standards in practice. However, these respondents also acknowledged the practical difficulties with developing ISAs from first principles. ASIC stated that:

[...] unlike accounting standards, there is no comprehensive formal conceptual basis underlying auditing standards that can be used to interpret and apply the principles. Arguably, the principles therefore need to be supported by a more rule-based guidance.

Expressing some support for rule-based standards, ASIC concluded that an increased focus on rules-based standards would not be inconsistent with the objective of having the highest quality auditing standards in Australia, and the IIAA believed that such standards are more readily measurable and enforceable and thus supported the adoption of rule-based standards.

### **Discussion of the approved strategic directions**

The FRC approved the final set of strategic directions for the AUASB in a meeting held on April 8, 2005 (Bulletin of the FRC, 2005, April 2, 2005). The final set of strategic directions, now codified in the *Foreword to AUASB Pronouncements* (Foreword) (AUASB, 2006a, b), has the same number of strategic directions as the proposed directions with little difference in substance. The final set of approved strategic directions appears to clarify rather than enhance the strategic directions originally proposed in the SDP. Table IV highlights the comparison between the proposed strategic directions (denoted with a numeric reference from (1) through to (5)) and approved strategic directions (denoted with an  $\alpha$  reference from (a) through to (e)). The comparison shows that much of the proposed strategic directions have been incorporated in the final set of approved strategic directions (with some reorganisation) with five key amendments: three additions to the proposed strategic directions; and two omissions to the proposed strategic directions. The three additions, include: the inclusion of the phrase "highest quality" in the approved strategic direction (a); a requirement to monitor auditing standards issued by national standard setters in the development of Australian auditing standards in approved strategic direction (d); and a requirement to conduct and participate in audit related research activities in approved strategic direction (e). The two omissions from the proposed strategic direction and therefore the FRC's SDP include: the requirement to contribute and participate in the international standard setting arena in proposed direction (4); and the formalisation of due process to ensure the AUASB operates on a transparent and open manner is removed in proposed strategic direction (5). These differences and related issues arising from the data analysis are discussed below.

#### ***The phrase "highest quality" and using ISAs as the base***

The proposed strategic direction (1) has been converted into two separate approved strategic directions (a) and (b) with little change in content. According to approved strategic directions (a) and (b), the AUASB must exhibit clear public interest focus using the ISAs as a base for Australian auditing standards and having regard to developments in other jurisdictions. One of the noticeable additions to approved strategic direction (a) is the inclusion of the phrase, "highest quality." This phrase is now captured in the *Foreword to AUASB Pronouncements* [12] (AUASB, 2006a, b, paragraphs 10-11), which emphasises the AUASB's commitment to the public interest by developing "high quality" auditing standards as a means to enhance the quality of information provided to users. KPMG (Big 4 audit firm) question the notion of "quality" and state that it is "subjective" and "it would

be unwise to enter into a debate on which standard setter has highest quality standards.” In spite of the subjectivity in the phrase “highest quality,” there appears to be an implicit assumption in the Foreword and the SDP, that ISAs are the key to developing “high quality” standards. Irrespective of the source of this phrase or its definition, basing auditing standards on ISAs implies that the IAASB produces high-quality standards in the public interest (Jubb and Houghton, 2007). Support for this contention is provided by Simnett (2007) who relies on data provided by the IAASB to assert that ISAs are currently the most widely used auditing standards in the world. According to the IAASB, more than 100 countries use ISAs that are adopted in their entirety or with local adaptation (web site: [http://web.ifac.org/download/IAASB\\_Brief\\_History.pdf](http://web.ifac.org/download/IAASB_Brief_History.pdf) (accessed August 14, 2007)).

With an increasing emphasis on internationalisation, the IAASB – a board of IFAC, has emerged as international authority for the global accounting profession responsible for developing ISAs. The Australian Government has consequently placed reliance on the authoritative pronouncements of the IAASB as a means to respond to the loss of confidence in auditing. However, according to Humphrey and Turley (2006) there is almost no research looking at IFAC's operating and governance structures. To this end, two concerns relating to independence are raised. The first concern relates to the question of an independent statutory model which was raised by ASIC in its response to consideration (a) discussed above. ASIC was critical of basing Australian auditing standards on ISAs developed by the IAASB because it departs from a public interest/statutory model of developing auditing standards (one aim of the CLERP 9 Act 2004) and returns to the professional/self-regulatory approach. According to this view, auditing standards are not developed independently from the profession. The second concern relates to the IAASB's membership structure which is dominated by the Big 4 audit firms from only a few countries, mostly the UK, USA and other Anglo Saxon countries. According to Humphrey and Turley (2006), the IAASB is a highly expert committee whose members bring considerable and invaluable expertise to the IAASB. However, loyalties and alignment are questioned, particularly when the USA is not committed to the ISAs promulgated by the IAASB (Simnett, 2007). The pressures facing individual members become a complex balancing act when members are seen as representatives of the large accounting firms and their national authorities. Simnett (2007) points out however, that during his tenure on the IAASB there was never a time when members were not acting in the public interest.

### ***Monitoring auditing standards issued by national standards setters***

In addition to using ISAs as the basis of developing Australian auditing standards required in approved strategic direction (b), the AUASB is also required in approved strategic direction (d) to monitor auditing standards issued by national standard setters and incorporate additional requirements where appropriate. According to the FRC (2004), the AUASB should monitor the projects and output of national standard setting bodies to seek out improvements or new initiatives that could be considered “world's best practice.” Monitoring the work of other standard setters will assist the AUASB to stay in touch with current standard setting trends and to address the new challenges as they arise. Proposed strategic direction (4) required the AUASB to contribute and participate in the work of the IAASB (this issue is discussed in more detail below) but was silent in regard to the work of national standard setters. Monitoring the work of national standard setters was a question raised by the FRC in the “Matters for Consideration.” Respondents to the SDP favoured a monitoring role for the AUASB but rejected the notion of adopting such standards. Even though the AUASB is required only to monitor and review, and not adopt auditing standards promulgated by national standard setters, approved strategic direction (d) may distract the AUASB's from its mission to minimise divergence from ISAs, particularly when national auditing standards differ significantly from ISAs. However, the adoption of such standards by the AUASB is unlikely when the spirit of AUASB's strategic directions, and its work programme, favour convergence with ISAs (Jubb and Houghton, 2007).

### ***Research***

Proposed strategic directions (2) and (3) which deal with the development of standards other than historical financial information and guidance on other auditing and assurance matters were redrafted into a single approved strategic direction (e). The issue of auditing standards on subject matters other than historical financial information was not addressed in the “Matters for Consideration.” Consequently, no changes were expected to this direction however, in addition to its original purpose,

direction (e) now incorporates a requirement to research. Approved strategic direction (e) directs the AUASB to conduct and participate in research that benefits its standard-setting activities. This requirement was not part of the proposed strategic directions policy but it was a focal point of Professor Houghton's[13] (academe) submission which drew attention to issues on independent research that were not specifically addressed by the "Matters for Consideration." While the structural changes to the AUASB were favourably viewed by Professor Houghton, he also noted the need for the AUASB to conduct independent research. That is to undertake research:

[...] which is not directly and exclusively funded nor executed by those in the profession who represent the providers of audit and assurance services nor should it engage in research that is expressly and exclusively financed by user groups and other stakeholders in the market for audit services.

According to AUS 102 (AARF, 2002, paragraph 30), the former board could initiate research in response to emerging issues resulting from submissions from third parties or the development of a pronouncement by an overseas accounting body such as the PCAOB or the IAASB. However, the reconstituted AUASB and the successor statement, *Foreword to AUASB Pronouncements* (AUASB, 2006a, b), is silent on how research will be initiated. Generating a research strategy is expected to be developed with the establishment of a Research Committee which was identified as a milestone in the AUASB's 2005-2006 work programme (FRC, 2005). By the end of the 2006 reporting period, the AUASB had established a Research Committee, but the Committee had yet to meet, and its plans for 2007 were silent (FRC, 2006). The AUASB's delay in establishing a research focus casts doubt, at least in the short term, on its ability to effectively satisfy a strategic direction to conduct and participate in research that benefits its standard-setting activities. According to Jubb and Houghton (2007, p. 25), the AUASB's ability to engage in research has fallen short of acceptable and it is unclear whether the AUASB's commitment to research will benefit its future work program.

### ***Removing the need to participate in the international standard setting arena***

Proposed strategic direction (4) states that the AUASB should participate in the international standard setting arena with a particular emphasis on providing input to the work of the IAASB. However, strategic direction (e) now omits the need to contribute to the international standard arena and states that the AUASB need only have regard to any program initiated by the IAASB and make appropriate amendments to Australian auditing standards accordingly. This direction defies the support expressed by the respondents for participating in the international standard setting arena and contradicts the view expressed by the FRC in 2004 which advocated the contribution and participation in the work of the IAASB in developing ISAs because it was seen as the appropriate means to promoting the concept of a single set of auditing standards in the public interest (FRC, 2004). To this end, membership on the IAASB and taskforces, and input into the work of the IAASB is seen by the FRC to be integral to the ability of the AUASB to continue as an effective national standard-setter.

For many years, Australia has been regarded as an influential international contributor through participation in IAASB meetings and related activities such as submissions to exposure drafts and task force papers (AUASB, 2006a, b, paragraph 20). Australia has had continuing representation on the IAASB since it was formed in 2002, with particular visibility in the category of public members, and according to Simnett (2007) – a former member of IAASB – Australia is well placed to continue its inclusion on the IAASB. In 2004, the FRC recommended that the AUASB continue its existing high level of involvement with international auditing standard setting and related activities. However, the shift in strategic focus from participation to consideration appears to be a fundamental change to the AUASB's strategic directions that could diminish Australia's contribution to, or influence, in the promulgation of international auditing standards. This could be a major concern when we consider Australia's standing in the international community. However, signs of tempering this diminished commitment to participation are now surfacing. The FRC stated in an open letter to the AUASB, dated April 6, 2005, that:

[...] while the strategic directions makes no reference to the AUASB participating in the work of the international bodies such as the IAASB, the FRC strongly encourages the involvement of the AUASB in such work.

Additionally, the AUASB's 2006-2007 work programme calls for involvement with IAASB meetings and contributing directly to IAASB projects by taking a leadership role in redrafting ISAs in the clarity format and providing comments on exposure drafts (FRC, 2006). Furthermore, the AUASB Corporate Plan 2006-2009 calls for participation in the standard-setting activities of the IAASB and liaise with other national standard-setters such as USA, Canada, UK, France and New Zealand (AUASB, 2006a, b).

### **Transparency**

The central issue in direction (5) is the application of due process to ensure the attainment of its statutory objects in a transparent and consultative manner. Direction (c) similarly directs the AUASB to make all necessary amendments to ISAs to ensure that the AUSs conform to the Australian regulatory environment and statutory requirements. The due process, now outlined in the *Foreword to AUASB Pronouncements* (AUASB, 2006a, b, paragraphs 38-44), promotes consultation by encouraging stakeholders to actively participate in the standard setting process. Proposed strategic direction (5) also included an obligation to ensure that it operates in a transparent manner, which is now omitted from the approved strategic directions. Rather, approved strategic direction (c) emphasises compliance and consistency with Australian Law, presumably to coincide with its new statutory responsibility to issue legally enforceable auditing standards under the Corporations Act 2001. Like proposed strategic directions (2) and (3), transparency and consultation were not specifically addressed in the "Matters for Consideration," so the rationale for their exclusion is unknown.

In spite of this omission, the AUASB is committed to transparency. The AUASB states in its Annual Report 2005/2006 (FRC, 2006) that it maintains a web site ([www.auasb.gov.au](http://www.auasb.gov.au)) designed to meet stakeholder information needs. In addition to publishing all standards and pronouncements, the web site provides information about the AUASB activities, work programmes, meeting agendas and meeting highlights. Making the minutes of meetings available on the web site will no doubt improve transparency, particularly when the minutes broadcast deliberations and issues discussed by committee members. However, unlike its sister body, the Australian Accounting Standards Board, the AUASB does not make the minutes of its meetings available to public; rather it publishes a "highlights" document which is a highly summarised version of the minutes. The extent of the Board's transparency will be improved with detailed minutes.

### **Summary and conclusion**

This paper examined internationalisation of Australian auditing standards by analysing the stakeholder submissions to the SDP and comparing the proposed and approved strategic directions frameworks of the AUASB. The overall response to the SDP was impressive with a diverse range of respondents. The approved strategic directions are consistent with the majority view of the respondents, which support minimal divergence from ISAs and using the ISAs as the base for developing Australian auditing standards. Rules-based auditing standards and standards developed in other jurisdictions should be monitored but not necessarily adopted. Such standards are developed for local market conditions, which may not be suitable to the Australian environment. Relying on ISAs for the development of Australian auditing standards means that the AUASB would be dependent on the work of the IAASB, implicitly assumed to produce "highest quality" standards. Notwithstanding quality-related issues, ASIC points out that a standard setting approach relying on ISAs is self-regulatory in nature and is inconsistent with the objectives of the CLERP 9 Act 2004. Additionally, problems arise when the ISAs lack relevance to the local environment and may undermine Australian standard setting expertise and Australia's role at international standard setting forums and discussions. Furthermore, it was claimed that ISAs are arguably limited because they focus too much on the needs of capital markets, a point of distinction between the submissions received from the Big 4 and the non-Big 4 audit firms.

The FRC outlined two objectives of the SDP relating to the internationalisation of auditing standards. The first objective addresses the appropriateness of basing Australian auditing standards on the standards issued by the IAASB. There is clear support from respondents for using the ISAs as the basis for developing Australian auditing standards. Even though the AUASB can develop standards specifically for the Australian environment (AUASB, 2006a, b, paragraph 36) the AUASB has,

wherever possible, used the ISAs as a base for its Australian auditing standards. According to the Foreword:

[...] the work of the IAASB is considered integral to the ability of the AUASB to continue as an effective national standard-setter and is important to the AUASB maintaining and further developing the auditing and assurance standards and related guidance (AUASB, 2006a, b, paragraph 20).

The AUASB has a longstanding policy of convergence and harmonisation with ISAs. This policy was initially formalised in 1994-1995, as a result of a co-ordinated international project in which Australia participated to codify ISAs (FRC, 2004). Ongoing support for convergence was outlined by the FRC in the SDP and is clearly supported by the submissions to the SDP. While the SDP broached the issue of basing Australian auditing standards on ISAs, the submissions to the AUASB and FRC's commitment to the ISAs does not appear to have significantly altered existing practice, rather it has crystallised Australia's longstanding practice of convergence which is likely to continue in the foreseeable future.

The second objective of the SDP is concerned with whether the AUASB should have regard to, or adopt, auditing standards developed by other international auditing standard setting bodies. A requirement to monitor and review the work of other standard setters was added to the AUASB's strategic directions by the FRC with the release of its revised policy. This addendum is consistent with the respondents' views, which supports the AUASB in giving consideration to standard developed by national standards setters but did not endorse the adoption of such standards.

The revised strategic directions were approved by the FRC in April 2005 with minimal changes to the originally proposed strategic directions. The international harmonisation of auditing standards in Australia, the focus of the revised strategic directions, now applies equally to auditing standards as it does to accounting standards. However, unlike accounting harmonisation where reservations were expressed about the quality of financial reporting in Australia and the political forces that shaped the harmonisation debate, the majority of respondents to the SDP supported the internationalisation of Australian auditing standards. Future research and debate will ultimately judge the efficacy of this approach, however in the short term, the harmonisation of Australian auditing standards appears acceptable to all stakeholders.

Overall, the views expressed by the majority of the respondents were consistent with the strategies proposed and adopted by the FRC. Five variations in the proposed and adopted strategic directions were noted and discussed. However, no significant evidence was found to suggest that particular stakeholders were successful in lobbying/influencing the FRC's final set of strategic directions for the AUASB. The present study did not specifically examine the lobbying positions or activities of the respondents. Thus, a study on evaluating the lobbying positions/powers of various stakeholders would be of particular value. The authors also acknowledge that the stakeholders who did not make submissions to the SDP were not included in the analysis, and thus the data are subject to a self-selection bias. Therefore, the analysis and conclusions in this paper should be interpreted with caution.

Audit firms – Big 4	1. Ernst & Young 2. Deloitte 3. KPMG
Audit firms/organisation – non-Big 4	4. PriceWaterhouseCoopers (PwC) 5. Grant Thornton 6. Pitcher Partners 7. PKF Australia Ltd 8. RSM Bird Cameron 9. Swindells DK (HLB Mann Jubb)
Auditor general	10. Australian Council of Auditors General (ACAG)
Professional associations – accounting	11. CPA Australia 12. Institute of Chartered Accountants in Australia (ICAA) 13. The Institute of Internal Auditors Australia (IIAA) 14. International Federation of Accountants (IFAC)
Professional associations – non-accounting	15. National Institute of Accountants (NIA) 16. Australian Shareholders Association (ASA) 17. Securities Institute of Australia (SIA)
Preparers of financial reports	18. Australian Institute of Company Directors (AICD)
Regulators	19. Group of 100 (G100) 20. Australian Prudential Regulatory Authority (APRA) <sup>a</sup> 21. Australian Securities and Investments Commission (ASIC)
Academe	22. Houghton KA (Australian National University) 23. Turnbull Shann (Principal at International Institute for Self-governance)

**Note:** <sup>a</sup>Submission declared confidential

**Table I.**  
List of the respondents

**Table I** List of the respondents

The FRC, in consultation with the AUASB, is considering the following matters concerning a proposed strategic direction for the AUASB

- (1) Should the objective of having the highest quality auditing standards take precedence over an objective of having minimal divergence from ISA, particularly given the role of auditing standards in the broader governance framework and the need to ensure standards have regard to the public interest?
- (2) Should the AUASB follow the approach of its predecessor and continue to use ISA as a basis for developing and making Australian auditing standards?
- (3) Does the “clarity of standards” project undertaken by the IAASB impose any time constraints on the ability of Australia using current ISA as a basis for developing and making auditing standards?
- (4) Should the AUASB have regard to, or even adopt, auditing standards made by standard setters other than the IAASB – such as the US PCAOB – when developing and making best practice auditing standards for Australia?
- (5) Are there any problems posed by adopting rules-based standards within a predominant principles-based standards regime and how should these be best addressed?

**Table II.**  
Matters for consideration

**Table II** Matters for consideration

Consideration	Yes		No		No comment	
	<i>n</i>	Percent	<i>n</i>	Percent	<i>n</i>	Percent
(a) Should the objective of having the highest quality auditing standards take precedence over an objective of having minimal divergence from ISA, particularly given the role of auditing standards in the broader governance framework and the need to ensure standards have regard to the public interest?	5	23	15	68	2	9
(b) Should the AUASB follow the approach of its predecessor and continue to use ISA as a basis for developing and making Australian auditing standards?	14	64	4	18	4	18
(c) Does the “clarity of standards” project undertaken by the IAASB impose any time constraints on the ability of Australia using current ISA as a basis for developing and making auditing standards?	4	18	13	59	5	23
(d) Should the AUASB have regard to, or even adopt, auditing standards made by standard setters other than the IAASB – such as the US PCAOB – when developing and making best practice auditing standards for Australia?	4	18	14	64	4	14
(e) Are there any problems posed by adopting rules-based standards within a predominant principles-based standards regime and how should these be best addressed?	14	64	4	18	4	18

**Table III.**  
Response rates

**Table III** Response rates

Proposed strategic directions	Approved strategic directions	Changes
(1) The AUASB will exhibit a clear public interest focus in its AUSs. In doing so, it will, where appropriate, use ISAs of the IAASB as a base from which it will develop its AUSs, and it will also have regard for developments in other jurisdictions	(a) The AUASB should develop AUSs that have a clear public interest focus and are of the highest quality	Proposed strategic direction (1) has been split among three approved strategic directions (a), (b) and (c) The phrase “highest quality” has been added in approved strategic direction (a) which did not previously exist
(2) The AUASB will continue to develop standards in respect of subject matters other than historical financial information	(b) The AUASB should use, as appropriate, the ISAs of the IAASB as a base from which to develop AUSs	Proposed strategic direction (2) is now incorporated in approved strategic direction (e) Approved strategic direction (b) has been adapted from proposed strategic (1)
(3) The AUASB will continue to develop and issue other guidance on auditing and assurance matters	(c) The AUASB should make such amendments to ISAs as necessary to accommodate and ensure that AUSs both exhibit and conform with the Australian regulatory environment and statutory requirements, including amendments as necessary for AUSs to have the force of law and be capable of enforcement under the requirements of the Corporations Act 2001 by June 30, 2006	Proposed strategic direction (3) is now incorporated in approved strategic direction (e) Approved strategic direction (c) extends the notion of adopting ISAs (as stated in approved strategic (2)), so that, where necessary, amendments to ISAs must occur to ensure AUSs remain relevant with the Australian regulatory environment and statutory requirements
(4) The AUASB will continue with its contributions to and participation in the international standards setting arena, and in particular, provide input to the work of the IAASB	(d) The process of developing AUSs should include monitoring and reviewing auditing and assurance standards issued by other standard setting bodies in other national jurisdictions and considering other matters relevant to achieving the objectives of Part 12 of the ASIC Act. Consequently, where appropriate and considered to be in the public interest and necessary to producing standards of the highest quality, the AUASB should incorporate additional requirements in its AUSs	Proposed strategic direction (4), which imposes a requirement to contribute and participate in the international standard setting arena, is now omitted Approved strategic direction (d) incorporates a requirement to monitor auditing standards issued by national standard setters in the development of Australian auditing standards
(5) The AUASB will also implement additional strategies to ensure the attainment of its main statutory objects, and in doing so, will formalise its due processes, so as to ensure that the AUASB operates in a transparent and consultative manner	(e) The AUASB should continue to develop auditing and assurance standards other than for historical financial information as well as developing and issuing other guidance on auditing and assurance matters, and may participate in audit research that is conducive to, and which significantly benefits, the standard-setting activities of the AUASB The AUASB should have regard to any program initiated by the IAASB for the revision and enhancement of ISAs and make appropriate consequential amendments to AUSs	Proposed strategic direction (5), which formalises due process to ensure the AUASB operates on a transparent and open manner, is omitted Approved strategic direction (e): has been adapted from proposed strategic direction (2) in regard to historical cost information and proposed strategic direction (3) in regard to issuing guidance statements; imposes a requirement to conduct and participate in audit related research activities that did not previously exist

**Table IV.**  
Proposed and adopted strategies of the AUASB – a comparison

**Table IV** Proposed and adopted strategies of the AUASB – a comparison

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