



AGENDA PAPER

Item Number: 10

Date of Meeting: 20 November 2019

Subject: Update on the Parliamentary Inquiry on audit regulation in Australia

Action required

 For discussion

 For noting

 For information

Purpose

To:

- provide the Board with an update on the Parliamentary Inquiry on audit regulation in Australia; and
- seek approval to publish a summary of prohibitions in the restructured Code relating to Public Interest Entity (PIE) audit clients.

Background

On 1 August 2019, an inquiry into the regulation of the auditing profession in Australia was referred to the Parliamentary Joint Committee on Corporations and Financial Services (PJC Inquiry). Refer to Agenda Item 10 (a) for the Terms of Reference for the inquiry.

The PJC sought submissions on the Terms of References with the comment period closing 28 October 2019.

To inform its submission, APESB held a roundtable on 30 September 2019 to discuss the PJC Inquiry and obtain stakeholder feedback on the effectiveness of APESB pronouncements and international developments. Mr. Ian McPhee AO PSM, a Board Member of the International Ethics Standards Board for Accountants (IESBA), presented on the current IESBA projects that fall within the PJC's Terms of Reference.

APESB's [submission](#) to the Parliamentary Inquiry, in summary, noted the following key matters for the Committee's consideration:

- the Australian Code (APES 110), including the auditor independence requirements, aligns with the International Code of Ethics issued by the IESBA which facilitates global commerce;
- APES 110 and the International Code of Ethics are global best practice;
- the Australian professional standards framework that applies at the firm level and in respect of various professional services is a global leader and is only replicated in a handful of jurisdictions which does not include the UK;

- there are existing professional and ethical requirements for professional accountants on conflicts of interest and the provision of non-assurance services that should be well-understood by Australian corporate sector. APESB is not aware of empirical evidence to suggest that there are significant weaknesses with our pronouncements;
- proposed global developments by the IESBA relating to the provision of non-assurance services and fees will drive change and enhancements to the way professional accountants address conflicts of interest and ensure that standards continue to meet changing global regulatory and community expectations;
- implementing more prescriptive disclosures for the different types of fees received by auditors (for example, audit, audit-related services and non-assurance services) and fees paid to consultants/firms other than the entity's auditor may inform the public and enhance the transparency of an entity's use of the services provided by accounting firms;
- any amendments to strengthen the current regulatory arrangements should carefully consider the existing professional standards framework in place and the uniqueness of the Australian regulatory and professional standards environment in comparison to other jurisdictions such as the UK; and
- we acknowledge that non-compliance with existing legislative, regulatory and professional standards obligations does occur. In these instances, we strongly support the regulators and monitoring bodies taking appropriate enforcement and disciplinary action.

Matters for consideration

At the date of writing this report, the PJC has published 91 submissions on the [Parliament of Australia website](#) received in response to their Terms of Reference. Technical Staff have reviewed the submissions to determine the key themes that may have an impact on APESB's activities.

Key themes in submissions to the PJC

There is a wide range of views expressed in the submissions made to the PJC inquiry so far. Some of the key themes or recommendations noted by Technical Staff include:

Provision of non-assurance services and conflicts of interest

Conflicts of interest occurring from providing non-assurance services were raised in a significant number of submissions. Most of the submissions from individuals (and a few academics) referred to what they believed were clear conflicts of interest in accounting firms providing consulting and auditing services to audit clients, or in providing advice to the Government.

In contrast, accounting firms, professional organisations and regulators noted there were clear frameworks in place for auditors to deal with conflicts of interest and strict prohibitions in respect of the provision of non-assurance services to audit clients.

There were also calls for the need for clearer definitions around audit services, audit-related services and non-audit services.

Audit quality

Most submissions noted that the definition of audit quality and how it should be measured are unclear. Several academics stated that audit quality is a function of auditor independence and competency. They noted there had been a significant focus on ensuring the independence of auditors, but if these reforms are not improving audit quality, then the focus needs to be on improving the competency of auditors.

Many submissions referred to multiple parties being responsible for audit quality – it is not just the sole responsibility of the auditor. It was suggested this could become a focus of Board Audit Committees and management, including emphasising their proportionate responsibilities in the financial reporting supply chain.

Rotation of firm or partner

Most submissions were supportive of the current audit partner rotation requirements (although one submission did suggest audit partners should rotate every couple of years). Some academics referred to evidence which seemed to support longer time on periods for audit partners enhanced audit quality.

Overall there was not a great deal of support for audit firm rotation. Rather, it was recommended a few times that a review of audit tenure should be undertaken on a regular basis (time frames suggested ranged from 10 to 20 years).

Competition in the audit market

There were very mixed views about competition – some saw the Big 4 as an oligopoly which needed to be broken up, others noted the need for firms of different sizes to service the different types of entities.

Suggested reforms to competition included the implementation of joint audits or giving mid-tier firms a step-up. There was not a great deal of support for either of these suggestions by respondents (even by some of the mid-tier firms).

The role and scope of audits

It was clear that the audit was considered a very valuable service, but its purpose and scope are not well understood by some stakeholders.

There were very few submissions that suggested audit should not change or evolve. A number called for the audit to cover other information in annual reports and to also provide assurance over management's assertions, review and analysis of the internal controls of an entity and its going concern considerations.

There were mixed views as to whether the scope of the audit should cover fraud, with those against this suggestion noting that fraud is not always easy to uncover.

Impact of international reviews on Australian reforms

Many submissions referred to the reviews that are occurring in the UK and urged the PJC to wait to consider the outcome of the Brydon review before developing proposals for Australia. A couple of respondents suggested that a review similar to the Brydon review should be undertaken in Australia to consider how the audit service should be reformed in the Australian environment.

A few submissions also urged the PJC to ensure that any reforms will fit into the Australian regulatory framework, which is different to the UK.

Matters for further consideration by the APESB

Acknowledging that the PJC inquiry is in its early stages, Technical Staff is of the view that the following matters will require further consideration or action by the Board in the coming months:

- the need for clarity in respect of the non-assurance services that can be provided to audit clients and analysis on whether additional guidance should be provided on prohibited services or on allowable services;
- the need to educate and clarify the role of the APESB and its mandate (as a number of submissions believed our role was broader than just standard setting).
- the impact of changes to APESB's structure, functions or the legal enforcement of its pronouncements if oversight of the APESB changes;
- the impact on resourcing if APESB is requested to undertake a review of the non-assurance services being provided by accounting firms to their audit clients (as suggested in PwC's submission);

PIE Prohibitions in the Code

Technical Staff have observed that some stakeholders have limited understanding of the prohibitions in the Code in respect to non-assurance services while there are others who have requested clarity in respect of the existing requirements. Technical Staff is of the view that this is a matter that should be addressed immediately.

In 2012, the International Ethics Standards Board for Accountants (IESBA) published a list of prohibited services and relationships for audit clients that are Public Interest Entities (PIEs). APESB Technical Staff have been liaising with IESBA Technical Staff on the possibility of updating this publication for the restructured Code.

We are pleased to report that the IESBA agreed to revise this publication and we are aware that they will be releasing an updated version on their website shortly. IESBA staff have provided a pre-release version for APESB Staff's information, which has been included as attachment 10 (b).

Technical Staff are also of the view that APESB should produce an APES 110 version of these prohibitions, to ensure any specific Australian prohibitions are captured and to educate and raise awareness of these prohibitions in Australia.

Accordingly, we have prepared a draft of the summary of the prohibitions in the restructured Code (APES 110) which is included at Agenda Item 10(c) for the Board's consideration.

Way forward

The PJC is expected to hold public hearings in November and December 2019 and is expected to release a report by 1 March 2020.

Technical Staff will continue to monitor the progress of this inquiry and will provide regular updates to the Board.

Staff Recommendation

The Board:

- approve the issue of the summary of the prohibitions in the restructured Code for PIE audit clients; and
- note the update on the Parliamentary inquiry on audit regulations in Australia.

Material Presented

Agenda Item 10 (a) PJC Inquiry – Terms of Reference;
Agenda Item 10 (b) IESBA's Summary of the PIE Prohibitions – November 2019; and
Agenda Item 10 (c) Draft Summary of prohibitions in the restructured APES 110 for PIE Audit Clients.

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