

Media Statement

Strong auditor independence requirements: a key feature of the revised Code of Ethics

By Channa Wijesinghe | 23 January 2020

The independence of the auditor is a key determinant of a robust audit regulatory framework, and this matter has received some attention at the Parliamentary Joint Committee's (PJC) inquiry on audit regulation in Australia, as well as globally. Based on a review of the submissions to the PJC inquiry, it is disappointing to note that a significant number of respondents to the inquiry appear to have a limited understanding of the existing auditor independence requirements in Australia that have operated for most of the last decade. While there are invariably instances of non-compliance with the existing auditor independence requirements which need to be appropriately dealt with, any new proposals need to take into consideration the existing requirements.

In addition, legislators should also take into consideration that from the first of January this year, the most substantial revision in the last two decades to the APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* ("the restructured Code") has now come into effect. The revisions to the Code, which is mandatory for audits and reviews in Australia, is the culmination of a five-year project to make auditor independence requirements stronger, clearer, and more enforceable by regulators and monitoring bodies. The new Code brings Australian auditors in line with the International Code and incorporates additional Australian-specific requirements.

The Australian Code (APES 110) is based on the International Code issued by the International Ethics Standards Board for Accountants (IESBA) and is developed in a globally transparent manner following a rigorous process overseen by the Public Interest Oversight Board. The restructured Code strengthens the approach to addressing threats to auditor independence and requires discontinuance of interests, relationships or services where threats could not be eliminated, or safeguards could not be appropriately applied.

A clear advantage of this principles-based approach, supplemented by prohibitions in specific circumstances, is that it stimulates thinking and the need to take action to address threats to an auditor's independence while being sufficiently broad to address future types of services firms may provide to audit clients. Compared to a prescriptive list of prohibited services alone, such as in the United States, we firmly believe we've created changes that will stand the test of time for years to come.

Another major change to the Code applies to the 'cooling-off' period for audit engagement partners of Public Interest Entity (PIE) audit clients. The 'cooling-off' period has now increased to three years and after 31 December 2023 will increase to five years. This goes further than the *Corporations Act 2001*, which only stipulates two years. While these are key enhancements, the existing Code has long-acknowledged the importance of auditor independence, including the distinction between services provided to Audit vs. Non-Audit Clients.

There is a difference between the Australian prohibitions in comparison with the United States in that some immaterial services can be provided in Australia. However, it is expected that even this exception may be removed due to changes proposed in an international exposure draft on non-assurance services issued yesterday by IESBA in New York.

We believe the existing prohibitions have restricted other services provided by firms to their audit clients and have been crucial towards upholding auditor independence. We favourably note, for example, that the ratios of fees for other services to audit fees disclosed in the firms' recent submissions to the PJC inquiry on audit regulation are significantly lower than the regulatory cap of 70% imposed in the European Union. An ASIC Audit Quality measures report issued in December 2019 covering audit firms of the ASX 300 entities indicate that the ratio of fees for these entities, in aggregate, for audit and other assurance services compared to all other services for the year ended 31 March 2019 was 22%.

Since 2011, APESB has prohibited an audit partner from being compensated or remunerated for their ability to sell other services to that partner's audit clients. These existing prohibitions on other services are extended in the restructured Code. For example, the prohibition on providing recruiting services in respect of key finance personnel to PIE audit clients is now extended to all audit clients from 1 January 2020.

Some of the matters noted here have been discussed at the PJC inquiry. The APESB has recommended to the inquiry that there should be enhanced disclosures in respect of audit, audit-related, and other services provided to audit clients as well as disclosure of services provided by other accounting firms in a consulting capacity. As well as recommending an expanded disclosure, the APESB has issued two additional submissions to the PJC to clarify the existing auditor independence requirements in Australia. It is also important to take into consideration differences in the Australian environment, such as the extensive range of APESB's professional standards that apply to non-assurances services in Australia. This comprehensive professional standards framework is a feature absent in most G20 jurisdictions, including the United Kingdom.

While the restructured Code, which commenced on 1 January 2020, will assist accountants and auditors in understanding and complying with the Code's requirements better, it is also expected to facilitate monitoring and enforcement by the regulators and professional bodies, which is a key component of an effective regulatory framework.

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Notes to Editors: APESB is the National Standards Setter that sets the code of ethics and professional standards by which members of Australia's three major professional accounting bodies (CPA Australia, Chartered Accountants Australia and New Zealand and the Institute of Public Accountants) are required to abide.