



10<sup>th</sup> May 2010

Mr. Peter Levy  
Audit Quality Strategic Review  
Corporations and Financial Services Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Peter,

**Re: Audit Quality in Australia: A Strategic Review**

Accounting Professional & Ethical Standards Board Limited (APESB) welcomes the opportunity to make a submission to Treasury on its paper *Audit Quality in Australia: A Strategic Review*.

APESB is pleased that Treasury has undertaken this study to identify key drivers of audit quality in Australia and to assess whether any measures should be taken to address potential threats to these drivers of audit quality. APESB commends the Treasury on its report and notes the findings of the study.

**The APESB role**

APESB is governed by an independent board of directors setting standards with the primary objective of developing and issuing, in the public interest, appropriate professional and ethical standards which apply to the membership of the three Australian professional accounting bodies. A secondary objective of the APESB is to provide the opportunity or forum for the discussion and consideration of issues relating to professional standards for accountants. The APESB is funded by the three major accounting bodies, but has complete independence in its standard-setting activities.

Our essential function is the setting of standards, and in doing this we endeavour to incorporate a strong emphasis on professionalism and the role of sound judgement in those accountants who are obliged to follow our standards. We believe that setting high quality standards with demanding criteria contributes to the professional standing and behaviour of members of the accounting profession.

The quality of audits and financial reporting is critical to the professional standing of accountants, as well as having a major impact on the 'public interest'. APESB is largely dependent on other bodies for the monitoring, review and enforcement of standards and we welcome the ongoing work of Treasury, ASIC and FRC in contributing to this. APESB promotes the importance of compliance with professional and ethical standards as far as it can within its mandate and we would always be pleased to participate and contribute to this activity in association with Treasury and other relevant bodies. We are in regular dialogue with the three accounting professional bodies in relation to their approach to monitoring professional and ethical behaviour. We are also close to the work of the IESBA in this area, and can have influence on its direction, particularly since I was appointed a member of that board earlier this year.

### **APESB's Code of Ethics and Professional Standards**

The major platform for the standards of professional and ethical behaviour is APES 110. APESB issued APES 110 *The Code of Ethics for Professional Accountants* (the Code) in June 2006 which is binding on members of the three professional accounting bodies in Australia. The Code is based on the international Code issued by the International Ethics Standards Board for Accountants (IESBA Code).

The Code was subsequently amended by amending standards (relating to Network Firm and Corporations Law Reform) and APESB issued a compiled version of the Code in February 2008.

The Code includes independence requirements applicable for members who conduct assurance engagements and thus will be binding on auditors who are members of the three professional accounting bodies in Australia.

APESB has also issued professional standards that govern the professional conduct of members in specialist areas such as forensic accounting, valuations, taxation and insolvency.

### ***Revision of APES 110 Code of Ethics for Professional Accountants***

APESB is currently undertaking a project to update the Code in line with the revised IESBA Code issued in July 2009. As a first step in the process the Board issued a Consultation Paper on its proposed revision in late 2009 to seek stakeholder views on key issues that impact the drafting approach to be adopted. The Board has now considered comments from stakeholders on the issues raised in the Consultation Paper and will be reviewing a first draft of the proposed Exposure Draft at its May 2010 Board meeting. The Board is presently planning to issue an Exposure Draft for public comment by 30 June 2010.

Some of the key changes in respect of auditor independence requirements in the new IESBA Code that would be of interest to your review are:

- Introduction of Public Interest Entities on whom the more stringent independence requirements of the Code will be applicable;
- Introduction of Key Audit Partner on whom the partner rotation requirements will be applicable in the case of Public Interest Entities. Previously the rotation requirements were only applicable to the Lead Engagement Partner, Audit Review Partner (if any), and Engagement Quality Control Reviewer. The expansion of the new definition will mean that Partners who audit significant subsidiaries of Public Interest Entities will also now be subject to rotation requirements; and

- The independence requirements for Audit and Review Engagements are split from the independence requirements for Other Assurance Engagements.

Attached for your information is a summary prepared by IESBA Staff which highlights the key changes in the new IESBA Code (Refer Appendix A).

I will inform you in due course when the Board issues the APESB's Code of Ethics as an Exposure Draft for comment as well as when the Board issues the final version of the Code later in the year. If you would like to discuss APESB's revision of the Code or require any additional information, please do not hesitate to contact me on 0418 836984 or Channa Wijesinghe, Technical Director on (03) 9642 4372 or email at [channa.wijesinghe@apesb.org.au](mailto:channa.wijesinghe@apesb.org.au).

Yours sincerely

A handwritten signature in cursive script that reads "Kate Spargo".

Kate Spargo  
Chairperson

## Appendix A

### Overview of Independence Requirements in the IESBA Code (July 2009)<sup>1</sup>

This paper provides an overview of independence requirements contained in Section 290 of the Code of Ethics released by the International Ethics Standards Board for Accountants in July 2009 that relate to rotation, cooling off period, provision of non-assurance services, fees and compensation and evaluation policies.

#### Public Interest Entities

- Listed entity provisions to be applied to all public interest entities.
- Public interest entities defined as:
  - Listed entities;
  - Entities defined by regulation or legislation as a public interest entity; and
  - Entities for which the audit is required by regulation or legislation to be conducted in compliance with the same independence provisions as apply to listed entities.

#### Cooling-off Period

- Applies to public interest entities.
- “Cooling-off” period required before Senior or Managing Partner of the firm joins an audit client that is a public interest entity or a Key Audit Partner joins the partner’s public interest entity audit client.
- Key audit clients defined as:
  - Engagement partner;
  - Engagement quality control reviewer; and
  - Other audit partners, if any on the engagement team, who make key decisions or judgments on significant matters with respect to the audit of the financial statements.
- Cooling-off period for Senior or Managing Partner – one year.
- Cooling-off period for key audit partners – one audit opinion covering a period of not less than 12 months for which the partner was not a member of the audit team.
- Cooling off period required before individual takes on of the following positions:
  - Director;
  - Officer; or
  - Employee in a position to exert significant influence over the preparation of the accounting records o financial statements.

#### Partner Rotation

- Applies to public interest entities.
- Key audit partners – rotate after seven years with time-out period of two years.

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<sup>1</sup> This document has been prepared by the IESBA staff to assist people with implementation. It is a non-authoritative document issued for information purposes.

- In rare cases due to rare cases, due to unforeseen circumstances outside of the firm's control, may be permitted to stay on the engagement if continuity is especially important to audit quality.
- Rotation not required when:
  - Independent regulator has provided an exemption from partner rotation where firm has only a few people with necessary knowledge and skill to serve as key audit partner; and
  - Independent regulator has provided alternative safeguards

### Non-assurance services

#### *Management Functions*

- A firm shall not perform management functions for an audit client
- Management functions:
  - Leading and directing an entity, including making significant decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources
- When providing non-assurance services management responsible for:
  - Making the significant decisions and judgments; and
  - Accepting responsibility for the actions to be taken as the result of the service

#### *Accounting and Bookkeeping Services*

- Non-public interest
  - Can provide services related to the preparation of accounting records and financial statements if services are of a routine or mechanical nature
- Public interest
  - Except in emergency situations, shall not provide accounting and bookkeeping services, including payroll services, or prepare financial statements or financial information which forms the basis of the financial statements

#### *Valuation Services*

- Non-public interest
  - Cannot provide valuations services that are material and involve significant subjectivity
  - Guidance on meaning of significant subjectivity – when the results of the valuation performed by two or more parties not likely to be materially different
- Public interest
  - Cannot provide valuation services if would have a material effect, separately or in the aggregate, on the financial statements

### *Tax Return Preparation*

- Such services do not normally create threats to independence provided management takes responsibility for the returns, including any significant judgments made:
  - The services are typically provided based on facts already in existence or transactions that have already occurred;
  - Analysis and presentation of historical information under existing law;
  - Tax return is subject to whatever review or approval process the tax authority considers is appropriate.

### *Tax Calculations*

- Non-public interest
  - Preparing calculations of current and deferred tax liabilities for the purpose of the preparation of the accounting entries may create a self-review threat. The significance of the threat will depend on:
    - Degree of subjectivity involved in the calculations; and
    - Materiality
- Public interest
  - Except in emergency situations, cannot provide service if for the purpose of preparing accounting entries that are material to the financial statements

### *Tax Planning and Other Advisory Services*

- Self-review threat may be created when advice affects matters reflected in the financial statements. Significance depends on:
  - Degree of subjectivity and materiality
  - Level of tax expertise of client
  - Extent to which advice is supported by law or regulation
  - Whether effectiveness of the advice depends on accounting treatment and there is reasonable doubt as to the appropriateness of the treatment
- Where the effectiveness of tax advice depends on a particular accounting treatment or presentation, and
  - Reasonable doubt as to appropriateness of the related accounting treatment or presentation; and
  - Outcome of tax advice will have a material impact on the financial statements
- Self-review threat would generally be so significant no safeguards could reduce the threat to an acceptable level

### *Assistance in Resolution of Tax Disputes*

- Advocacy threat may be created when firm represents audit client in resolution of a tax dispute once tax authorities have rejected client's argument and are referring the matter for determination in a formal proceeding. Significance depends on:
  - Whether firm has provided tax advice on the matter
  - Materiality
  - Extent to which matter supported by tax law or regulation
  - Role management plays in the resolution of the dispute

- If services involve acting as an advocate for an audit client before a public tribunal or court in the resolution of a tax matter and the amounts are material to the financial statements created would be too significant
- What constitutes a public tribunal or court depends upon how the tax proceedings are heard in the particular jurisdiction

#### *Internal Audit Services*

- Non-public interest
  - Shall only provide internal audit services if firm is satisfied that management takes responsibility for the services
  - Shall not assume a management responsibility
  - Performing a significant part of the internal audit activities increases possibility of assuming a management responsibility
- Public interest
  - Shall not provide internal audit services that relate to:
    - A significant part of the internal controls over financial reporting
    - Financial accounting systems that generate information that is, separately or in the aggregate, material to the financial statements
    - Amounts or disclosures that are, separately or in the aggregate, material to the financial statements

#### *Information Technology Services*

- Non-public interest
  - Design or implement likely to create too significant a self-review threat unless specified safeguards are applied
- Public interest
  - Shall not provide design or implementation services
- All entities
  - Installation of pre-packaged software *is acceptable provided required customization is insignificant*

#### *Litigation Support Services*

- Non-public interest
  - Shall not provide service involving estimation of damages if matters are material and involve a significant degree of subjectivity
- Public interest
  - Shall not provide services involving estimation of damages if matters are material

### *Corporate Finance Services*

- Public interest
  - Shall not provide services when
    - Effectiveness of advice depends on a particular accounting treatment
    - Advice is material
    - Reasonable doubt as to appropriateness of accounting treatment

### *Recruiting Services*

- Public interest
  - Shall not provide the following services with respect to a director or officer or senior management in a position to exert significant influence over the preparation of the accounting records or financial statements
    - Search for or seek out candidates
    - Undertake reference checks of prospective candidates

### *Fees*

- Public interest
  - If total fees from an audit client exceed 15% of total fee of the firm for two years
    - Pre-issuance review performed by professional accountant who is not a member of the firm: or
    - Post-issuance review performed by professional accountant who is not a member of the firm

### *Partner Compensation and Evaluation*

- Key audit partners shall not be evaluated on or compensated based on the partner's success in selling non-assurance services to their audit clients
- Compensating or evaluating other members of the audit team for selling non-assurance services may create a threat