



Australian Government
Financial Reporting Council

FINANCIAL REPORTING COUNCIL

ANNUAL REPORT

2017-18



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Australian Government
Financial Reporting Council

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20 September 2018

The Hon Stuart Robert MP
Assistant Treasurer
Parliament House
CANBERRA ACT 2600

Dear Assistant Treasurer

I have pleasure in presenting the annual report of the Financial Reporting Council (FRC) for the year ended 30 June 2018.

The report has been prepared in accordance with section 235B of the *Australian Securities and Investments Commission Act 2001* (ASIC Act) for tabling in the Parliament. Subsection 235B(1) of the ASIC Act requires the FRC to prepare a report on its operations during the year, and on the achievement of the objects of Part 12 of the ASIC Act relating to accounting and auditing standards.

As required by subsection 235B(2), the report includes details of advice the FRC provided to the Australian Accounting Standards Board and Auditing and Assurance Standards Board over the year. Subsection 225(2B) of the ASIC Act further requires the FRC to provide strategic policy advice and report on the quality of audits conducted by Australian auditors.

Subsection 235B(4) of the ASIC Act requires the report to be tabled in each House of the Parliament as soon as practicable.

Yours sincerely

A handwritten signature in black ink that reads 'B. L. Edge'.

Bill Edge
Chair

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Chair's report

In 2017-18 the Financial Reporting Council (FRC) continued to oversee the effectiveness of the financial reporting system in Australia, including processes for setting accounting and auditing standards and overseeing the quality of audits conducted by Australian auditors.

The year has seen substantial activity in Australian standard setting, and continuing dialogue around international standard setting arrangements and audit quality, both internationally and in Australia.

The FRC recommends the Minister continues to support the activities of all stakeholders that collectively aim to maintain and improve audit quality.

Audit quality

In last year's Annual Report the FRC noted the lack of improvement found by the Australian Securities and Investments Commission (ASIC) Audit Inspection Review Program.

Accordingly, the FRC has continued to work with ASIC, the Auditing and Assurance Standards Board (AUASB), the accounting firms, the accounting bodies and directors to understand the root causes of non-compliance and remedial measures required.

The FRC prepared an Audit Quality Action Plan which is discussed in more depth in Section 3 of this Annual Report.

One key FRC initiative undertaken during the year was a survey, in conjunction with the AUASB, of Audit Committee Chairs (ACCs) to seek their views on audit quality.

Overall, the results of the survey indicated that ACCs were very satisfied with the quality of their auditors (refer Section 3). Whilst the FRC welcomes these positive results, the FRC notes that the emphasis on audit quality improvement needs to be maintained.

The Australian Financial Reporting Framework Project

The FRC supports The Australian Financial Reporting Framework Project being undertaken jointly by the Australian Accounting Standards Board (AASB) and the AUASB with the aim of reshaping the Australian financial reporting framework, by working with regulators to develop objective criteria on:

- who prepares financial reports;
- what needs to be reported; and
- the nature and extent of assurance required on financial reports.

A significant step in this process is the release for comment in May 2018 of AASB ITC 39 'Applying the International Accounting Standards Board's (IASB's) Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems'.

External reporting

Many entities are providing, and investors and other stakeholders are asking for, more than financial reports, including information on an entity's strategy, governance and business model, key resources and relationships, and social and environmental issues (known more broadly as 'external reporting').

Accordingly, the FRC issued a Position Statement on External Reporting which states that the FRC supports voluntary adoption of external reporting, although it does not, at this time, support a mandatory or prescriptive approach as the trend to external reporting is still in its early stages.

The FRC, the AASB and the AUASB will continue to monitor the extent and quality of external reporting in Australia as practice continues to develop and evolve.

Monitoring Group Consultation Paper

The Monitoring Group which is responsible for standard-setting processes for the development of international standards for audit, assurance and ethics sought views on those processes.

The FRC made a submission with clear views that:

- the Public Interest Oversight Board (PIOB), entrusted with assuring the protection of the public interest, should have its responsibility limited to public interest oversight issues and strategic direction;
- the model of two separate boards to oversee auditing and assurance, and ethics, respectively should be retained; and
- further details on alternative funding models need to be provided.

Public sector issues

The FRC considered issues specific to the public sector, particularly:

- the FRC direction to harmonise Government Financial Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting;
- the AASB's assessment of International Public Sector Accounting Standards (IPSAS);
- the impact of The Australian Financial Reporting Framework Project on the public sector; and
- audit quality in the public sector.

These issues form part of the work program of the AASB and the AUASB and will continue to be closely monitored by the FRC.

Stakeholder engagement

The FRC considers it essential that regular contact be maintained and communication strengthened with all stakeholders interested in or affected by financial reporting.

We thank those stakeholders who regularly communicate with us, particularly:

- Association of Superannuation Funds of Australia (ASFA);
- Australian Charities and Not-for-profits Commission (ACNC);
- Australian Council of Superannuation Investors (ACSI);
- Australian Institute of Company Directors (AICD);
- Australian Prudential Regulation Authority (APRA);
- Australian Securities and Investments Commission (ASIC);
- Australian Securities Exchange (ASX);
- Australian Shareholders' Association (ASA);
- Business Council of Australia (BCA);
- Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ);
- CPA Australia;
- Commonwealth Department of Finance;
- External Reporting Board of New Zealand (XRB);
- Financial Services Council (FSC);
- Governance Institute of Australia (GIA);
- Group of 100 (G100);
- Institute of Internal Auditors-Australia (IIA);
- Institute of Public Accountants (IPA);
- Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC); and
- The Commonwealth Treasury

The number of organisations listed above indicates the broad range of stakeholders affected by the financial reporting system.

Statutory obligations

Each year the FRC conducts a review of its performance against the obligations required of it under the *Australian Securities and Investments Commission Act 2001* (ASIC Act). Our review this year confirmed that the FRC continues to satisfy all of its statutory obligations.



Mr Bill Edge

Chair
Financial Reporting Council

20 September 2018



FRC members and observers

Left to Right: Alyce Reid (Treasury), Adam Bogiatzis (Treasury), Stein Helgeby, Graeme Mitchell, Judith Downes, Damian Paull (AASB/AUASB), Professor Roger Simnett AO (Chair AUASB), Bill Edge (Chair FRC), Kris Peach (Chair AASB), David Nicol, Kevin Lewis, Sue Piper (Treasury), Warren Allen (XRB), Kate O'Rourke (Treasury).

Absent: Jackie Callaway, Noelle Kelleher

Objectives and composition of the FRC

1

FRC objectives

The FRC is the peak body responsible for overseeing the effectiveness of the financial reporting system in Australia.

The ASIC Act sets out the core objectives for the financial reporting system including:

- to facilitate the Australian economy by:
 - reducing the cost of capital;
 - enabling Australian entities to compete effectively overseas;
 - having accounting and auditing standards that are clearly stated and easy to understand; and
- to maintain investor confidence in the Australian economy, including its capital markets.

The FRC functions include providing broad oversight of the accounting and auditing standard setting processes for private and public sectors, giving the Minister reports and advice about such matters, and establishing appropriate consultative mechanisms.

Specifically, the FRC functions include giving strategic policy advice and reports to the Minister and professional accounting bodies in relation to the quality of audits conducted by Australian auditors.

The FRC is the peak body responsible for overseeing the effectiveness of the financial reporting system in Australia.

FRC members

Members of the FRC are appointed on a part-time basis by the Minister, typically for a term of three years.

During the year Jackie Callaway accepted an employment position in the United Kingdom and so resigned as a member of the FRC.

The FRC acknowledges her significant contribution to the FRC.

The membership of the FRC throughout 2017-18 was as follows:



Mr Bill Edge
Chair
FRC

Bill is a retired partner of PricewaterhouseCoopers (PwC), having been a partner for 18 years.

For his last eight years he led the PwC Australia Risk and Quality Group, which was responsible for risk management and quality control, including methodologies and technologies, across all of the firm's business units. He served on PwC's Global and Asian Risk and Quality Leadership Teams. He also spent six years leading the PwC Australian Professional Standards Group responsible for the firm's financial reporting and auditing policies and advice. He was also previously Chair of the Australian Auditing and Assurance Standards Board.

Bill was appointed Chair on 29 April 2016 and has been a member of the FRC since July 2014. His term expires on 28 July 2019.



Ms Jackie Callaway
Chief Financial Officer
Devro plc

Jackie joined Devro plc in London as Chief Financial Officer on 1 May 2018. Jackie was most recently Group Financial Controller of Brambles Limited, the ASX Top 20 supply chain logistics company, where she led Brambles Global Finance transformation program. Between 2008 and 2013 she was Chief Financial Officer of Consolidated Minerals Limited, the manganese ore producer, where she led a \$405 million refinancing and was responsible for investor relations. Jackie has also held further senior finance roles at amongst others Fonterra Co-operative Group Limited, New Zealand's leading dairy producer.

Jackie was appointed to the FRC on 29 April 2016 and resigned on 20 June 2018.



Ms Judith Downes
Chair
Bank Australia

Judith is Chair of Bank Australia, the first customer owned bank in Australia, and a non-executive director of a listed medical technology company. She has previously been a member of the Standards Advisory Council of the IASB and of the AASB. She is an Honorary Fellow at the University of Melbourne. Judith's past experience includes Chief Financial Officer of a listed mining company, non-executive director of a listed property company, and Chief Financial Officer and Chief Operating Officer of the Institutional Division of one of Australia's largest banks.

Judith was appointed to the FRC on 29 April 2016 and her term expires on 28 April 2019.



Ms Noelle Kelleher
Chief Financial Officer
Vision Super

Noelle has nearly 30 years' experience in the financial services industry, with a particular focus on superannuation. Prior to joining Vision Super, Noelle was a partner at two of the Big 4 professional services firms. Noelle is also company secretary for the Vision Super companies.

Noelle was appointed to the FRC on 3 June 2009 to 2 June 2012, reappointed from 31 August 2012 to 30 August 2015, with an extension from 29 April 2016 to 28 April 2019.



Dr Stein Helgeby
Deputy Secretary
Department of Finance

Stein joined the Department of Finance in February 2010 as the Deputy Secretary of the former Financial Management Group. In October 2015 Stein was appointed Deputy Secretary of Governance and APS Transformation. Prior to this, Stein enjoyed a lengthy period in the Victorian Department of Treasury and Finance.

Stein was appointed to the FRC from 24 February 2010 to 23 February 2013, reappointed from 24 February 2013 to 23 February 2016, with an extension from 29 April 2016 to 28 April 2019.



Mr Kevin Lewis
Chief Compliance Officer
ASX

Kevin is the Chief Compliance Officer of the ASX and a member of the ASX Corporate Governance Council.

Prior to joining ASX, he was a lawyer for 30 years, specialising in financial services, mergers and acquisitions and corporate matters. He held a number of senior positions with law firms and as in-house counsel.

Kevin is also an Adjunct Professor with Sydney University Law School teaching financial services law.

Kevin was appointed to the FRC on 14 March 2011 to 13 March 2014, reappointed from 14 March 2014 to 3 April 2017, with an extension from 4 April 2017 to 3 April 2020.



Mr Graeme Mitchell
Chair
XRB

Graeme is a chartered accountant and professional director, being Deputy Chair of National Provident Fund Board of Trustees and a Director of Retirement Income Group Limited. He also chairs the Audit Committees of the Ministry of Justice, and the Human Rights Commission, and is an independent member of the audit committee of Housing New Zealand and Porirua City Council. He is also the Honorary Consul General for Norway and was made an Officer of the Royal Norwegian Order of Merit in 2009 for services to Norway overseas.

Graeme is a retired Deloitte Audit and Assurance Partner.

Graeme was appointed to the FRC on 3 July 2014 and his term expires on 28 February 2019.



Mr David Nicol
Under Treasurer, Treasury and
Economic Development Directorate
of the ACT Government

David, as Under Treasurer, advises the ACT Treasurer on the management of the Territory's budget, covering strategic issues of financial management, economic policy, revenue and tax policy and federal financial relations. David's responsibilities also cover matters of workers compensation, compulsory third party insurance and other insurances, and the shared corporate services provider for the ACT Public Service.

David is also Chair of the HoTARAC and he has extensive experience in public budgeting and financial reporting and in public policy areas of social welfare and income support, government service delivery, industry, labour market and education.

David was appointed to the FRC on 3 July 2014 to 7 March 2017 and reappointed from 24 March 2017 to 23 March 2020.



Ms Kris Peach
Chair
AASB

Kris has extensive experience in accounting standard setting having previously served on the AASB as both a member and as the Deputy Chair and as a member of the Australian Urgent Issues Group.

Kris was previously a partner in KPMG's International Standards Group and Australia's Department of Professional Practice, interpreting complex technical accounting issues for a wide range of public and private entities. She also had a number of international financial reporting leadership roles within the firm.

Kris was appointed to the FRC on 3 November 2014 and her term expires on 2 November 2019.



Professor Roger Simnett AO
Chair
AUASB

Roger is also Scientia Professor of Auditing, UNSW Sydney where he has been head of the School of Accounting, Associate Dean Research of the Australian Business School and Academic Director of the Centre for Social Impact.

He has extensive experience in the auditing industry including significant involvement on international committees and advisory panels relating to auditing and assurance.

Previously he was a member of the IAASB and AUASB and is currently a member of the International Integrated Reporting Committee's framework review panel. Roger is a Fellow of the Academy of the Social Sciences in Australia.

Roger was appointed to the FRC on 1 April 2017 and his term expires on 31 March 2022.



Operations of the FRC Nominations Committee

During 2017-18, the FRC Nominations Committee:

- reviewed the composition of, and criteria for appointment to, the AASB and the AUASB;
- made recommendations to the FRC for the appointment of members to the AASB and AUASB;
- reviewed the succession needs of the AASB and AUASB in discussion with the Chair of the AASB and AUASB respectively;
- considered and reported to the FRC on the performance of the AASB and AUASB members including through peer review; and
- assisted the FRC Chair in undertaking a performance assessment of FRC members, the AASB Chair and the AUASB Chair.

Oversight of Australian standard setting

2

FRC functions

The FRC functions, as set out in the ASIC Act, include:

- determining the broad strategic direction of the AASB and AUASB;
- appointing members of the AASB and AUASB (other than the Chairs);
- monitoring the operation of accounting and auditing standards and the effectiveness of consultative arrangements of the AASB and AUASB;
- giving advice or feedback to the Boards and their offices on priorities, business plans and procedures, budgets and staffing arrangements; and
- monitoring the development of international standards.

The FRC works to promote the development of a single set of accounting and auditing standards for world-wide use and promotes the continued adoption of international best practice standards in the Australian standard setting processes.

The ASIC Act expressly limits the FRC's ability to direct the AASB or AUASB in relation to the development, or making, of a particular standard. The FRC does not have the power to veto a standard made, formulated or recommended by the AASB or AUASB.

The FRC works to promote the development of a single set of accounting and auditing standards for world-wide use...

Determining strategic direction

Since its establishment, the FRC has made three determinations concerning the broad strategic direction of the AASB and AUASB:

- to require the AASB to work towards the adoption of accounting standards that are the same as those issued by the International Accounting Standards Board (IASB) (Direction approved 5 September 2002);
- to require the AASB to pursue the harmonisation of Government Financial Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting (Direction approved 12 December 2002); and
- to require the AUASB to use auditing standards issued by the International Auditing and Assurance Standards Board (IAASB) as a base from which to develop the Australian standards, to develop auditing and assurance standards other than for historical financial information, and to participate in audit research that is conducive to the AUASB's standard-setting activities (Direction approved 4 April 2005).

The FRC monitors the operation of Australian accounting and auditing standards to assess their continued relevance and effectiveness in achieving their objectives...

Each of these directions is still current and the FRC continues to monitor their appropriateness. The FRC is satisfied that the AASB and the AUASB (the Boards) have implemented these directions to the extent practicable.

In 2016, the AASB conducted a review of International Financial Reporting Standards (IFRS) adoption in Australia. The AASB maintains IFRS compliance for For-profit entities with public accountability (e.g. listed companies, banks, insurers) and uses IFRS as a base for all other entities. Whilst the review indicated that further modifications to IFRS should be considered for specific issues in the Not-for-profit sector, using IFRS as a base continues to be appropriate.

Appointment of members to the Boards

The ASIC Act provides that the members of the Boards (other than the Chairs) hold office on the terms and conditions determined by the FRC. During 2017–18 the FRC approved the following appointments and re-appointments to the Boards for the terms commencing in 2018:

AASB

- Ms Carmen Ridley (reappointment);
- Mr Mike Blake (reappointment);
- Ms Alison White (appointment); and
- Mr Ken Liow (appointment).

AUASB

- Ms Julie Crisp (appointment); and
- Associate Professor Noel Harding (appointment).

The FRC was supported by the FRC Nominations Committee in the appointments process.

The FRC acknowledges the contributions of retiring Board members:

- AASB: Mr Andrew Kearnan, Ms Megan Wilson.
- AUASB: Ms Nonna Martinov-Bennie, Mr Colin Murphy.

Monitoring the operation of accounting and auditing standards

The FRC monitors the operation of Australian accounting and auditing standards to assess their continued relevance and effectiveness in achieving their objectives in respect of both the private and public sectors in the Australian economy. Based on the reports of the Chairs of the AASB and AUASB and the FRC members' knowledge of how the standards operate in practice, the FRC is satisfied:

- the AASB and AUASB have incorporated IFRS and International Standards on Auditing (ISA) into Australian accounting and auditing standards within reasonable timeframes in accordance with the Strategic Directions;
- the AASB and AUASB have adequate post implementation review processes to assess the effectiveness of new standards and guidance, and that regular agenda consultation processes identify existing accounting and auditing standards where further guidance is necessary; and
- the AASB and AUASB consult appropriately before issuing new standards or guidance and that such mechanisms appropriately include roundtables, education sessions, webinars, podcasts, LinkedIn and Twitter.

Giving advice or feedback to the Boards and their offices

The Chairs of the AASB and AUASB provided written and oral reports on the activities of the AASB and AUASB to each FRC meeting which included progress on:

- the aligned AASB and AUASB Strategy 2017-21; and
- the aligned AASB and AUASB Corporate Plan 2017-18.

Other specific matters or documents considered by the FRC during 2017-18 included:

- AASB For-Profit Standard Setting Framework;
- AASB Not-for-Profit Standard Setting Framework;
- AASB Approach to International Public Sector Accounting Standards;
- The Australian Financial Reporting Framework Project;
- AASB ITC 39 'Applying the IASB's Revised Conceptual Framework and Solving the Reporting Entity and Special Purpose Financial Statement Problems';
- Regulation of superannuation funds' financial reports and audits;
- AUASB action plan for audit quality;
- AASB and AUASB agenda consultation mechanisms;
- AASB Research Reports on Financial Reporting Requirements for Charities, Public Sector Entities and For-Profit Private Sector Companies; and
- AASB Discussion Papers on Improving Financial Reporting for Australian Charities and Australian Public Sector.

The FRC is satisfied that the advice or feedback provided has been appropriately addressed by the AASB and AUASB.

Further details of the activities of the AASB and AUASB are provided in their annual report.

Monitoring the development of international standards

In accordance with the ASIC Act, the FRC's functions include furthering the development of a single set of accounting standards, and a single set of auditing standards for world-wide use.

The international accounting standards with the most widespread adoption are the IFRS Standards issued by the IASB. These have been adopted in over 100 countries.

The FRC notes that the AASB monitors the work of the International Public Sector Accounting Standards Board (IPSASB) and where appropriate, utilises their guidance to modify IFRS for the Not-for-profit sector. The FRC and the AASB reassess regularly whether the Australian public sector should be using IPSAS or IFRS as a base for all sectors.

The international auditing standards with the most widespread adoption are those issued by the IAASB. These have been adopted in over 120 countries.

The FRC is satisfied that the advice or feedback provided has been appropriately addressed by the AASB and AUASB.

Additionally, the AASB and AUASB regularly report to the FRC their activities to build and enhance key relationships with both global and national standard setters designed to monitor and influence international developments.

International appointments

The FRC continues to monitor and influence the appointments of Australian representatives to key international accounting and auditing bodies. Current Australian members of key international bodies include:

- IASB member — Professor Ann Tarca.
- IAASB member — Ms Fiona Campbell.
- IFRS Foundation Trustee — Ms Lynn Wood.
- IASB Accounting Standards Advisory Forum (ASAF) members — Ms Kris Peach, working with the New Zealand Accounting Standards Board (NZASB) representative, Ms Kimberley Crook.
- International Ethics Standards Board for Accountants (IESBA) member — Mr Ian McPhee.
- IPSASB member — Mr Mike Blake.

Regional relationships

Australia and New Zealand continue to work closely together to facilitate harmonisation of Trans-Tasman standard setting.

In New Zealand the External Reporting Board's (XRB) structure contains three entities, the Board of the XRB and two standard setting boards — the NZASB and the New Zealand Auditing and Assurance Standards Board (NZAuASB). The FRC Chair is a member of the XRB and the XRB Chair is a member of the FRC as part of the arrangement for cross-appointments between Australia and New Zealand.

The Chairs of the AASB /AUASB and the NZASB/NZAuASB are also each a member of their counterpart board.

The AASB and NZASB work closely on the ASAF. The AASB also continues to closely work with the Asian Oceania Standard Setters Group (AOSSG).

The AUASB is an active member of the IAASB's National Standards Setters group where it works closely with the NZAuASB and other prominent auditing and assurance standard setters from the world's largest economies.

Australia and New Zealand continue to work closely together to facilitate harmonisation of Trans-Tasman standard setting.

Audit quality

Background

Australia has comprehensive legislative and professional requirements concerning audit with the main legislative requirements set out in the *Corporations Act 2001* (Corporations Act). ASIC is the key regulator under the Corporations Act and has responsibility for the surveillance, investigation and enforcement of the financial reporting requirements of the Corporations Act, including the regulation of audit requirements.

The Corporations Act gives legal effect to the auditing standards developed by the AUASB. The auditing standards require that auditors adhere to the relevant ethical standards as issued by the Accounting Professional and Ethical Standards Board (APESB). The professional accounting bodies also enforce professional standards and comprise: Chartered Accountants ANZ, CPA Australia and the IPA.

FRC's functions

Under the ASIC Act, the FRC's functions include giving strategic policy advice and reports to the Minister and professional accounting bodies in relation to the quality of audits conducted by Australian auditors.

This advice may include matters relating to the provisions of the Corporations Act, auditing standards or codes of conduct and matters relating to the quality assurance reviews carried out by the professional accounting bodies.

The ASIC Audit Inspection Program results released in June 2017 showed a lack of improvement...

As part of this role, the FRC Chair gave evidence to the Parliamentary Joint Committee on Corporations and Financial Services on 16 February 2018.

Audit Quality Action Plan

The ASIC Audit Inspection Program results released in June 2017 showed a lack of improvement for listed and significant public interest entities and that ASIC believed further work and, in some cases, new or revised strategies were needed to improve audit quality. The inspection results and audit quality were discussed with the former Minister for Revenue and Financial Services at the FRC meeting in November 2017. The FRC concluded that it was premature to propose any legislative changes but that it would continue to monitor closely actions being taken and results achieved over the next year.

Subsequently, the FRC Chair met with the Chair and Chief Executive Officer (CEO) of each of the Big 4 accounting firms and the CEO of each of the professional accounting bodies to seek their observations on audit quality and their proposed action.

The FRC Chair also wrote to stakeholder groups interested in financial reports to seek their perspectives.

The FRC considered the feedback at the FRC meeting in February 2018. The input provided to the FRC by stakeholders did not raise any systemic issues or major concerns that external auditing was not satisfying its core role of maintaining trust and confidence in the financial statements prepared by Australian companies. The FRC also noted that at this time, based upon ASIC’s financial statement surveillance results, the audit quality concerns did not appear to have resulted in a significant level of restatement of financial statements.

Following the February 2018 meeting, the FRC prepared an FRC Audit Quality Action Plan to achieve the following specific objectives:

- to engage with users of financial reports to better understand their views on audit quality;
- to undertake appropriate actions on the learnings of the ASIC Audit Inspection Program to contribute to the continuous development of best practice programs to assess audit quality; and
- to engage with professional accounting bodies, firms providing audit services, and other stakeholders to support initiatives that improve audit quality.

This action plan is an ongoing process that relies on and involves many stakeholders, particularly ASIC, the accounting firms and the professional accounting bodies, to achieve the desired level of improvement in audit quality.

The balance of this Section of the Annual Report outlines actions taken and in progress.

...the results indicate that the ACCs are very satisfied with the quality of their auditors.

Audit Committee Chairs Survey

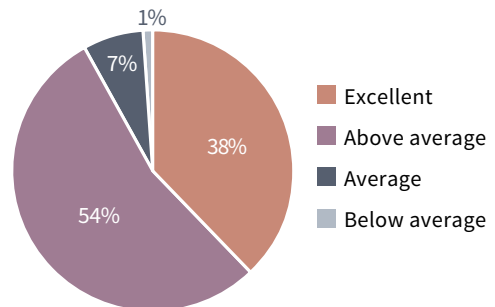
One of the key initiatives undertaken during the year was an ACCs Survey with the aim of gathering their views on audit quality and suggestions for improvement.

This survey was a joint initiative of the FRC and the AUASB and replicated selected questions from a survey of this nature carried out regularly by the United Kingdom’s FRC.

The survey was sent to ACCs of the ASX top 300 companies with the assistance of ASIC, the Australian Public Policy Committee (APPC — made up of representatives from the Big 6 accounting firms and the accounting bodies) and the Big 4 accounting firms. There were 91 responses representing a 30 per cent response rate.

Respondents ascribed a scale of 1 to 7 to several questions. In this context, the ‘expected’ level is reported as 4 (average), and a score of 1 would suggest that immediate action is required to improve audit quality. Open ended questions were also used to seek detailed responses.

The chart below represents the results of a specific question asking for an overall view of the external auditor.



Overall the results indicate that the ACCs are very satisfied with the quality of the auditors.

The responses included recommendations for improved practices by both auditors and audit committees.

Those recommendations will also be compared with responses to the International Organisation of Securities Commissions' (IOSCO) Consultation Report on 'Good Practices for Audit Committees Supporting Audit Quality'. The final international report is due to be released in late 2018, and the FRC will consider what further action may be required.

Other specific actions

With the support of the FRC, the AUASB and ASIC have met and are working through a list of areas where more guidance may be required in the auditing standards. The AUASB has also met with each of the Big 6 accounting firms to understand areas where they believe more guidance may be required.

The FRC conducted a review of professional and academic literature internationally which identified a range of Audit Quality Indicators (over 30) with various degrees of measurability. A summary of the literature was prepared and analysed by the FRC, which will support consideration of further recommendations by the FRC.

Initiatives by the accounting profession

The Big 4 accounting firms are all members of their respective global firm networks which are also reacting to the International Forum of Independent Audit Regulators (IFIAR) annual inspection findings which show a general improvement but the level of findings continues to be of concern to IFIAR.

The global firms implement initiatives which apply to their member firms in

The accounting firms in Australia...are collaborating and sharing best practices for the benefit of the accounting profession.

Australia, as well as conducting internal quality assurance programs to assess compliance by member firms.

The FRC is not privy to all such initiatives and internal quality assurance program results, but have discussed with the firms the concern over ASIC audit quality inspection results.

The FRC is confident that the leadership of the Big 4 accounting firms in Australia are displaying appropriate seriousness about concerns over audit quality. Those firms are implementing robust accountability mechanisms, undertaking extensive communication and education, and conducting detailed analysis of root causes followed by implementation of corrective action.

The accounting firms in Australia, to the extent permitted by anti-competition laws, are collaborating and sharing best practices for the benefit of the accounting profession. In particular, the APPC has supported the ACC Survey previously mentioned as well as two other key priorities:

- individual recognition and accountability frameworks for audit quality – this project, led by CPA Australia, is aimed at understanding the best practices in accountability frameworks for audit practice leaders, audit engagement partners and engagement quality control reviewers; and
- root cause analysis – this project, led by Chartered Accountants ANZ, is aimed at understanding best practices for an effective root cause analysis process and to drive improvement in the quality of audit engagements.

Australia's auditor regulatory regime includes cooperation between ASIC and the professional accounting bodies.

The aim also is to scale these best practice learnings from both projects to small and medium sized firms.

In addition, each accounting firm that audits ten or more entities listed on the ASX produces a public annual transparency report which outlines initiatives implemented to address audit quality and other relevant information.

Other notable initiatives during 2017-18 include:

Chartered Accountants ANZ

- Hosting a roundtable of senior representatives from the audit profession, business and regulators to discuss the quality, integrity and future of audit in Australia;
- Developing a joint publication with the Association of Chartered Certified Accountants (ACCA); *Directors' Responsibilities for Financial Reporting* which includes the role directors can have in influencing the quality of the audit process;
- Running annual Audit and Accounting Conferences in most states, including sessions on audit quality, key learnings from ASIC audit inspection findings and insights from Chartered Accountants ANZ Quality Review Program and disciplinary processes;
- Issuing *Audit Essentials* guidance for 31 December 2017 and 30 June 2018, highlighting matters raised in the ASIC inspection process; and
- Updating the *Audit Manual and Toolkit for Small and Medium-Sized Entities* and the *Audit Guide and Toolkit for Self-Managed Superannuation Funds*, to provide practical applications of quality control and documentation requirements.

CPA Australia

- Seeking to improve the quality of Self-Managed Superannuation Funds (SMSFs) audits through articles, guidance and podcasts to draw attention to identified compliance issues for SMSF auditors; and
- Bringing the CPA Quality Review team together with the ASIC Inspection team to ensure a consistent approach was being undertaken and compare findings to support the quality of the program.

IPA

- Requiring that an increased sample of Registered Company Auditors (RCAs) be subjected to face-to-face quality assurance (QA) reviews in addition to the online QA review. The new reviewers hold current registration as RCAs;
- Strengthening the online QA system in terms of the review of RCAs requiring a more in-depth analysis of the work and processes of RCAs;
- Increasing the education, training, continuing professional development and resources offered to RCAs to ensure they are up to date and fully competent to undertake audit work at the highest level; and
- Undertaking audit quality thought leadership initiatives through the IPA Deakin SME Research Centre, including on the definition of audit quality through international comparative analysis.

Review processes

Australia's auditor regulatory regime includes cooperation between ASIC and the professional accounting bodies. Each organisation conducts an inspection or review program which encompasses audit engagements.

Each of the programs is different and complementary to manage different risks, participants and types of engagement, and to maintain a focus on audit quality. Accordingly, statistics gathered by each organisation may not be comparable.

ASIC Audit Inspection Program

ASIC inspects audit firms that audit listed entities and significant public interest entities. These are mostly large and medium size firms that are not subject to a duplicate review by the professional accounting bodies. All audit partners reviewed are RCAs.

In June 2017, ASIC released the results of audit firm inspections for the 18 months to 31 December 2016. They are summarised in the table below:

	18 mths to 30 Jun 2015	18 mths to 31 Dec 2016
Audit firms reviewed	21	23
Audit files reviewed	111	93
Key audit areas reviewed	463	390
Key audit areas non-compliant ¹	19%	25%

¹Key audit areas non-compliant means that the auditor did not obtain reasonable assurance the financial report as a whole was free of material misstatement.

ASIC's findings continue to be similar in nature to previous years and those of audit oversight regulators in other countries. When releasing the report, ASIC said that auditors play a critical role in ensuring investors can be confident of the soundness of financial reports and well informed. Given the efforts by firms to improve audit quality and the consistency of execution of audits, ASIC was of the opinion this was a disappointing result. ASIC believed the findings suggested that further work and, in some cases, new or revised strategies were needed to improve audit quality.

ASIC's findings do not necessarily mean that the financial reports audited were materially misstated. Rather, in ASIC's view, the auditor did not have sufficient basis to support their opinion on the financial report. ASIC's inspections focus on higher risk audit areas, and so caution is needed in generalising the results across the entire market. The results should be viewed as an indication of how some firms address more challenging audit situations. ASIC said that audit firms should continue to pay particular attention to:

- the audit of asset values;
- the audit of revenue; and
- maintaining a strong culture of audit quality.

The next ASIC report on inspections of audits in the 18 months to 30 June 2018 will be issued in late 2018, covering audits up to 31 December 2017 year ends. Many of the initiatives mentioned throughout this Section may have an impact on later audits.

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ASIC activities to support audit quality include its financial reporting surveillance program, auditor surveillances not related to their inspections, investigations into corporate collapses, and addressing matters from complaints and other intelligence, as well as the following specific initiatives in 2017-18:

- reviewing the approaches of the Big 6 accounting firms to root cause analysis of internal and external findings, and their approaches to project management of audit engagements;
- leading the development of an IOSCO consultation report on good practices for audit committees in supporting audit quality, with the final report due to be released in late 2018; and
- leading an IOSCO survey of international financial reporting regulators with results also due to be released in late 2018.

ASIC also works with securities and audit regulators in other countries to promote audit quality.

In 2017-18 ASIC:

- cancelled two registrations of company auditors following audit quality concerns; and
- removed 149 auditors who did not meet their obligations from the SMSF auditor register.

Chartered Accountants ANZ Quality Review Program

The Quality Review Program (the Program) is an integral component of Chartered Accountants ANZ's professional compliance framework. The Program is designed to assess whether the approximately 14,300 Australian Certificate of Public Practice holders and affiliates (auditors and non-auditors) have implemented appropriate quality control policies and procedures in their practices.

Where these policies and procedures require enhancement, Chartered Accountants ANZ actively work with individual practices to remediate problem areas.

The results of the Chartered Accountants ANZ Quality Review Program from the 235 firms (including audit firms, non-audit firms and mixed firms) reviewed in 2017-18 are summarised in the following table.

	2015-16	2016-17	2017-18
Satisfactory	81%	83%	82%
Re-review required in 12 months	19%	17%	18%
Unsatisfactory	0%	0%	0%

The majority of re-reviews were required as a result of inadequate quality control procedures and/or insufficient documentation of audit evidence.

In order to assist members to identify likely problem areas, Chartered Accountants ANZ compiled a comprehensive list of top issues for various engagement types linked to tools and resources designed to assist members achieve compliance.

CPA Australia Quality Review Program

CPA Australia members who hold a Public Practice Certificate (approximately 6,650 members) are subject to the CPA Australia Quality Review Program. These reviews include members who are RCAs and registered SMSF auditors.

CPA Australia expected, in the 2018 calendar year, to review over 1,150 members in the Quality Review Program and to conduct a further 38 'follow up' reviews.

The results from the CPA Australia Quality Review Program for the past three years are summarised in the following table.

	2016 Calendar year	2017 Calendar year	2018 Calendar YTD
'Accept' reports – no departures identified	30.3%	23.9%	19.6%
'Minor departure' reports – no serious departures identified	62.3%	68.1%	70.5%
'Follow-up' reviews – multiple departures identified	7.4%	7.9%	9.8%

The philosophy of the program is that compliance is based on good education. Peer reviewers conduct the quality reviews which enable mentoring to support and enhance members' performance.

IPA Quality Review Program


The IPA requires all members who are issued with a Professional Practice Certificate to undertake a Professional Practice Quality Assurance Review every three to five years. All RCAs and SMSF Auditors are required to be reviewed every three years.

In the 2018 calendar year, the IPA is expected to review over 620 members. The results from reviews are summarised in the table below.

	2016 Calendar year	2017 Calendar year	2018 Calendar YTD
Compliant	61%	48%	25%
Non-compliant	11%	16%	17%
Follow-up required - members referred to Pronouncement 12 or their review is deferred	23%	28%	48%
No further action – members that are newly retired or ceased membership	5%	8%	10%

Where non-compliance is identified during a review, the issues are followed up with the members to ensure they are resolved. Serious non-compliance issues may also be referred for investigation which may result in referral to the IPA Disciplinary Tribunal for imposition of a penalty.

Members are referred for disciplinary action under *IPA Pronouncement 12 – Administration of Member Compliance* (effective as at 14 September 2016) where they fail to complete the review or provide information and/or undertake actions as requested to finalise the review.



The IPA website contains information and resources to assist members in completing the review.

A report of review outcomes is produced periodically to assist with identifying common issues and implementing measures to improve compliance and the process.

FRC overall view on audit quality

The FRC will continue to monitor the results of the ASIC Audit Inspection Review Program and the programs of the accounting bodies, and will continue to execute the FRC Audit Quality Action Plan.

Key to achieving continuous improvement of audit quality is collective action by all stakeholders in the financial reporting system.

Based on the evidence to date, the FRC believes that external audits continue to assist in maintaining trust and confidence in financial reports.

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G100	Group of 100
GAAP	Generally Accepted Accounting Principles
GFS	Government Financial Statistics
GIA	Governance Institute of Australia
HoTARAC	Heads of Treasuries Accounting and Reporting Advisory Committee
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IESBA	International Ethics Standards Board for Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors-Australia
IOSCO	International Organisation of Securities Commissions
IPA	Institute of Public Accountants
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
ISA	International Standards on Auditing
NZASB	New Zealand Accounting Standards Board
NZAuASB	New Zealand Auditing and Assurance Standards Board
PIOB	Public Interest Oversight Board
RCA	Registered Company Auditor
SMSF	Self-Managed Superannuation Fund
XRB	External Reporting Board of New Zealand



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