

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.

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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.

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Audit Committee Chairs Survey

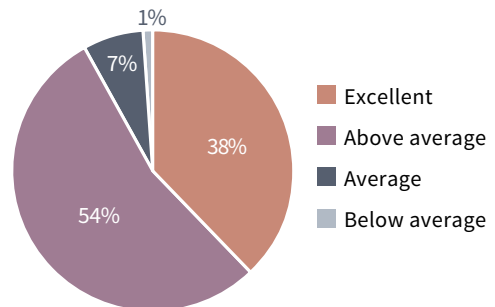
One of the key initiatives undertaken during the year was an ACCs Survey with the aim of gathering their views on audit quality and suggestions for improvement.

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

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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.

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