

3 May 2019

John Price
Executive Director
Commissioner
Australian Securities and Investments Commission
100 Market St
Sydney NSW 2000

Dear Mr Price

ASIC Audit Inspection Program

This letter outlines views and some information which we trust will be helpful in ASIC's ongoing audit inspections work, as well as in responding to the recent recommendation of the Parliamentary Joint Committee on Corporations and Financial Services¹ (PJC C&FS) concerning audit quality.

We reiterate our support for ASIC in its important role of conducting the audit inspection program. It is our desire to work together toward the vital common objective of reliable audited financial reporting in which investors and other stakeholders can be confident. We appreciate the collaborative working relationship we have with ASIC in undertaking this role and would like to acknowledge the valuable insights generated by the program and the many great people at ASIC who undertake it.

Since inception in 2005, ASIC's audit inspection program has become an integral part of Australia's audit quality framework. The program influences the focus and approach of auditors and accountants in carrying out their work, the attention of standard setters and policy makers on accounting and auditing matters, and the confidence of the public and stakeholders in Australia's capital markets and the accounting profession.

We strongly encourage ASIC to comprehensively benchmark the audit inspection program against international best practice on regulatory inspections and enforcement, with the opportunity for stakeholders to provide input. In responding to the PJC C&FS's recommendation for a study on audit quality, we encourage ASIC to aim for simplicity, understandability and an outcomes focus. In our view this means giving primacy to (a) the reliability of financial reports in Australia's capital markets/other public interest entities and (b) the confidence of investors and other users of financial reports.

¹ "The committee recommends that ASIC devise and conduct, alongside or within its current Audit Inspection Program, a study which will generate results which are comparable over time to reflect changes in audit quality." - Statutory Oversight of the Australian Securities and Investments Commission, the Takeovers Panel and the Corporations Legislation Report No. 1 of the 45th Parliament, Parliamentary Joint Committee on Corporations and Financial Services.

International best practice for regulatory inspections and enforcement

Attached are two international best practice references which we believe are an essential benchmark for ASIC's audit inspection activities:

- [OECD Best Practice Principles for Regulatory Policy: Regulatory Enforcement and Inspections](#)
- [OECD Regulatory Enforcement and Inspections Toolkit](#)

These documents provide an overarching framework to support initiatives on improving regulatory enforcement through inspections, and a tool for assessing inspection and enforcement systems. We recognise ASIC is likely already meeting many of the norms set out in these best practices, for instance in taking a risk-based approach. However, we strongly encourage ASIC to comprehensively benchmark its audit inspection activities against these best practices with input from stakeholders including those subject to inspections.

Measuring and reporting performance

ASIC's reporting on the audit inspections program provides useful information for the profession on key areas to focus efforts in improving audit quality. At the same time, the statistics reported concerning volume of findings and files reviewed have gained substantial attention as a proxy measure of the performance of auditors in the media and among policy makers. Achieving clear perspectives on performance is a fundamental part of international regulatory best practice. We believe this is especially important considering the PJC C&FS's recommendation for ASIC to develop "a study which will generate results which are comparable over time to reflect changes in audit quality".

Relevantly, the OECD Regulatory Enforcement and Inspections Toolkit states:

Using volume of activities (inspections) or violations detected (and sanctions) as indicators gives perverse incentives to inspecting agencies, since they then have an incentive to achieve low compliance levels, which will give them more volume – and runs contrary to their mission. Performance should be assessed against the achievement of social well-being (safety, health, environmental protection etc.) and, as an intermediate step towards this and a proxy for these goals, against improvements in compliance. It is indispensable that this be defined as a central task and indicator for inspection and enforcement structures.

We believe the social benefit objectives of the audit inspection program and auditing generally are best encapsulated as:

- The reliability of financial reports in Australia’s capital markets/other public interest entities; and
- The confidence of investors and other users of financial reports.

We encourage ASIC to provide more information and analysis on its financial reporting surveillance activities which provides a more outcomes-based perspective on audit quality in Australia. This may include for example analysing the volume and dollar value of restatements arising from ASIC’s financial reporting surveillance, with clear distinction between restatements and adjustments occurring in later years that ASIC believe may have arisen from its enquiries; as well as the full list of company reports ASIC has reviewed.

The perspectives of investors and other users of financial reports are of utmost importance as these are the ultimate customers of the information provided through the auditing process. The Australian Financial Reporting Council’s (FRC) studies on the views of audit committee chairs and professional investors are an important source of information on this perspective and we are also engaged in developing research to further illuminate this area.

In reporting on its audit inspections program, and in responding to the PJC C&FS recommendations, we encourage ASIC to aim for simplicity, understandability and an outcomes focus, rather than a process and compliance focus. Auditing as a process is by necessity highly judgement and risk based and therefore measuring process and compliance without the context of outcomes may not provide an accurate indication of quality and whether it is working toward its objectives or not. Policy, standards and practice influenced by an imbalanced perspective may over time jeopardise the high level of quality that exists in Australia’s financial reporting at present. Potential adverse unintended impacts on auditing practice over time include incentivising more compliance-based approaches to audit, while disincentivising appropriate risk-based approaches which are essential to continuing to deliver quality audited financial reporting.

Reliability of and confidence in Australian audited financial reporting

- ASIC reported that between 2010 and 2017, 4% of its financial report reviews resulted in ‘adjustments’, which includes both misstatements which required financial reports to be reissued, as well as instances where accounting changes were made in subsequent years which ASIC believed may have been related to its enquiries. Since 2014 when public information on each ‘adjustment’ has been available, approximately 1% of announced ‘adjustments’ appear to have related to restatements of financial reports.
- The FRC’s study on audit committee chairs’ perspective on audit quality in Australia indicated they are “very satisfied with the quality of their external auditor with 92% rating them ‘Above average’ or ‘Excellent’”.
- The FRC’s study on professional investors’ perspective on audit quality in Australia indicated “93% of professional investors indicated audit quality is “average” or “above”.

Other observations

Some further observations that have been shared with CA ANZ, for ASIC to consider in bench marking its audit inspection activities:

- How differences of view on judgmental matters are resolved within the inspections process.
- Time and resources involved as well as the timeliness and clarity of reporting outcomes of inspections with those subject to inspection.
- How information on the severity of findings is communicated.
- How file review findings are contextualised regarding the overall audit engagement and/or firm wide quality control.

As always, we are eager to work with ASIC to help achieve the best possible dissemination of the important messages arising from its inspections and surveillance, and build these into training, tools, and resources for Chartered Accountants to address areas for improvement on an ongoing basis. We are also ready to assist as needed to facilitate input and feedback regarding the audit inspection program and support ASIC's ongoing efforts to carry out its important role in continuing to achieve high quality audited financial reporting and confidence in Australia's capital markets and other public interest entities.

The appendix provides information about Chartered Accountants Australia and New Zealand. If you have any questions about this letter, please contact Amir Ghandar, Reporting and Assurance Leader, at Amir.Ghandar@charteredaccountantsanz.com.

Yours sincerely



Amir Ghandar CA
Leader, Reporting and Assurance



Simon Grant FCA
Group Executive, Advocacy and Professional Standing

Cc: Bill Edge
Chair
Financial Reporting Council

Appendix

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 121,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation accounting professionals across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.