INSTITUTE OF PUBLIC ACCOUNTANTS®

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Mr David Tellis
Executive Director, Treasury, ATO and Education Branch
Performance Audit Services Group
Australian National Audit Office

Submitted via: https://www.anao.gov.au/work/performance-audit/australian-securities-and-investments-commissions-regulation-of-registered-company-auditors

Dear Mr Tellis

Australian National Audit Office (ANAO) Performance Audit – Australian Securities and Investments Commission's (ASIC) regulation of registered company auditors

The Institute of Public Accountants (IPA) is one of the three professional accounting bodies in Australia, having been established in 1923, and represents over 50,000 accountants, business advisers, academics, and students throughout Australia and internationally. Three quarters of the IPA's members work in or are advisers to small business and Small to Medium Enterprises (SMEs).

IPA welcomes the opportunity to provide comments on the ANAO's Performance Audit on the effectiveness of ASIC's regulation of registered company auditors (RCA).

Given the broad nature and scope of the performance audit, we have confined our comments to substantive matters and offer overarching comments on the proposals below, with more details of our views in Attachment 1.

ASIC's policy on the regulation of RCAs is to assess minimum competency and integrity requirements, and regulate the on-going RCAs' conduct. IPA is of the view that ASIC's regulation of RCAs is essential to providing investors and the community at large with confidence in the credibility of the audited financial reports by RCAs. IPA also supports the need for imposing minimum standards on both the competency and integrity of RCAs. We think ASIC has broadly achieved these objectives in the registration and regulation of RCAs where practitioners no longer satisfy the necessary requirements. However, we think that ASIC's effectiveness and efficiency in regulating RCAs can be improved. Accordingly we offer the following observations and recommendations:

1. Develop different tiers of auditors proportionate to an entity's complexity and type of reporting
The current one-size fits all RCA registration requirements are no longer fit for purpose and in need of redesign to enhance the cogency of registered and regulated auditors that provide audit and assurance services to different scaled entities with varying degrees of risk complexities. The different tiers of registered auditors can have different eligibility requirements with RCAs retaining its existing high bar and the new registered/approved auditors having reduced requirements that specify minimum standards of competencies and integrity. The new tier of registered/approved auditors would enable members, such as those of IPA, to apply their knowledge and experience that meet the new reduced eligibility requirements. This would add auditors to the diminishing and inadequate pool of available auditors. We recommend ASIC

review and develop new auditor registration requirements for the above tiers, along with the auditor registration and renewal costs that are proportionate to the complexities of the reports to be assured and the tier of auditors that perform the audit engagement.

2. Surveillance and inspection program

While IPA supports ASIC's financial reporting and audit surveillance program, we think that ASIC needs to review the following areas:

- **Selection and number of files for audit** – We question whether the number of financial reports reviewed and audit files are adequate given the number of entities ASIC regulates. We recommend ASIC review its basis for selecting audit files for surveillance and the number to be selected.
- **Financial reporting and audit findings** – The identified concerns for the most recent inspection are in the same areas as those in the preceding years of impairment of assets and revenue recognition, where the application of judgement is required. However, Accounting Standards for these areas have not changed significantly since they were first issued some years ago, and yet continue to be problematic areas for compliance. Additionally, the concerns of auditors in auditing these areas are fundamental to auditors performing their duties. It is important that ASIC undertakes a root cause analysis of these perceived ongoing areas of non-compliance. Understanding the underlying reasons for the recurring non-compliance will enable ASIC to work with stakeholders such as standard-setters, preparers and auditors to reduce the non-compliance. This is important with mandatory sustainability reporting, which requires considerable application of judgement.
- **Technical expertise** – We think it is critical that ASIC's staff has the necessary financial reporting, sustainability reporting and assurance technical competencies and experience. To assist ASIC in the efficient and effective regulation of RCAs, we recommend ASIC review its resource capabilities, along with its industry funding model that links the fees levied with the level of ASIC regulatory activities, and increasing the penalties for misconduct.

3. Co-regulation concerns and sharing of information

Currently:

- **Co-regulation** – where ASIC finds the auditor's conduct is deficient, it may refer the matter to the Companies Auditors Disciplinary Board (CADB). By referring the matter to the CADB for determination, we think the CADB, not ASIC, is performing the role of an enforcer for the misconduct of RCAs. ASIC is essentially more of a regulator than an enforcer. We think, the role of the CADB should be included in the remit of ASIC as a regulator and enforcer.
- **Sharing of information on non-compliance by an accountant** between ASIC and the Professional Accounting Bodies (PABs) is inadequate. To protect the public's interest, a formal process should be put in place to ensure an individual's misconduct is shared with the relevant regulators and PABs. A similar approach under the *Tax Agent Services Act 2009*, enabling the Tax Practitioners Board to share the outcome of their investigations with the PABs should be adopted. We think that as co-regulators of auditors' compliance with audit and professional standards, regulation by each 'body' should be open and transparent and have a spirit of sharing information of interest to related bodies.

For any questions relating to this submission, please contact Vicki Stylianou, Group Executive Advocacy and Professional Standards, Institute of Public Accountants at vicki.stylianou@publicaccountants.org.au.

Yours sincerely

Vicki Stylianou
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Attachment 1 – IPA's detailed comments on the ANAO's Performance Audit

1. Develop different tiers of auditors proportionate to an entity's complexity and type of reporting
IPA is of the view that the current one-size fits all RCA registration requirements are no longer fit for purpose and in need of redesign to enhance the cogency of registered and regulated auditors that provide audit and assurance services to different scaled entities with varying degrees of risk complexities.

Currently, the audit of an Australian company, disclosing entity, registered scheme or Australian financial services (AFS) licences for the purposes of the Corporations Act can only be undertaken by RCAs (ASIC Regulation Guide 180). Additionally, some State legislation specifies when only RCAs can perform an audit. The current regime essentially means that only RCAs can audit the specified entities' financial reports irrespective of the complexity of the entity. The consequence of this is that smaller practitioners, such as IPA members, who are able to audit the less complex entity's financial report but do not satisfy all of ASIC's eligibility registration requirements are excluded from doing so.

The financial reporting and auditing landscape has changed in the last few years and will continue to change considerably with the introduction of mandatory sustainability reporting. The changes include:

- A trend of auditors exiting the profession and an insufficient number of auditors entering the profession and
- An increase in demand for auditors with the introduction of mandatory sustainability reports.

Our members have expressed concerns that:

- The shortage of auditors is a growing risk to financial reporting integrity. As the pool of auditors shrinks, audit bottlenecks, reduced competition, and higher costs are becoming more prevalent. These challenges undermine the ability of entities (including those in the not-for-profit and public sector), particularly those with complex financial reporting requirements, to obtain high-quality audits. The introduction of new sustainability reporting and assurance standards will only place a further strain on an already struggling profession.
- Some members have decades of auditing experience in SMSF audits that are outside ASIC's RCA requirements and perform complex audits along RCAs and yet there is no place for them in the current ASIC's regulation of company auditors regime.
- The RCA application process can be ambiguous, involved, lengthy and costly, that creates an unnecessary barrier to registration. Due to the ambiguity of the process and information requests, our members have cited examples where applicants had to furnish multiple tranches of information to support their application over a period of time. This resulted in unnecessary additional costs (arising from the additional time expended to obtain the information) and delay in processing the application.

IPA thinks there are merits for introducing different tiers of registered auditors for the differing tiers of financial reporting and types of audit/assurance requirements that exist outside the Corporations Act that often restrict the performance of audit/assurance services to RCAs. A model similar to those in other jurisdictions, such as New Zealand is worth examining for adoption. The possible tiers of registered auditors could be:

(1) Retain the existing financial report auditors of RCAs for Tier 1 general purpose financial statements and sustainability reporting for Group 1 entities and
(2) Introduce a new tier of 'approved', 'registered' or 'licensed' auditors for financial report and sustainability report audits of :

- Tier 2 general purpose financial statements and impending Tier 3 financial reports of smaller entities with less complex financial reports and
- Sustainability report of Group 2 and Group 3 entities.

The different tiers of registered auditors would have different eligibility requirements with RCAs retaining its existing high bar and the new registered/approved auditors having reduced requirements that contain a certain minimum standard of competencies and integrity.

The second tier of registered/approved auditors would be areas where members, such as those of IPA, can apply their knowledge and experience that meet the new eligibility requirements. This approach would add auditors to the diminishing and inadequate pool of available auditors.

We, therefore, recommend ASIC review and develop new auditor registration requirements for the above tiers, along with the auditor registration and renewal costs. The revised requirements and costs should be proportionate to the complexities of the reports to be assured and the tier of auditors that perform the audit engagement. Stakeholders should also be consulted in the development of the changes and the proposed changes be made available for public comment prior to their finalisation.

2. Surveillance and inspection program

The objective of ASIC's financial reporting and audit surveillance program is "to promote confident and informed participation by investors and consumers in the financial system" that aims "to improve the quality of financial reporting to ensure financial reports have been prepared in accordance with the law. We also aim to promote the improvement and maintenance of audit quality." (ASIC Information Sheet 224).

ASIC Report 799 "ASIC's oversight of financial reporting and audit 2023-24" summarises the approach and findings from its most recent financial reporting and audit surveillance program. IPA offers the following observations and recommendations:

- **Selection and number of files for audit**

  ASIC's financial reporting and audit surveillance programs reviewed 188 financial reports and 15 related audit files at 11 audit firms. Additionally, the audit surveillance program uses a risk-based approach to select audit files for surveillance "where a financial report has been subject to a review, and we are concerned that a financial report may have a risk of material misstatement. This is because there is a direct relationship between shortcomings in a financial report and the quality of audit work undertaken on the financial report." (page 4).

  We question whether the number of financial reports reviewed and audit files are adequate given the number of entities ASIC regulates. That is, in the previous year's surveillance program Report 774 states that, "We regulate about 29,000 entities that are required to lodge financial reports with ASIC. This includes over 1,900 ASX-listed entities and over 27,000 unlisted entities. We also regulate 3,200 registered company auditors and authorised audit companies. More than 500 registered company auditors and authorised audit companies audit one or more listed entities." (page 2, which is absent in Report 799). We, therefore, recommend ASIC review its basis for selecting audit files for surveillance and the number to be selected.

- **Financial reporting and audit findings**
  ASIC's financial reporting and audit surveillance programs identified concerns with:
  - inadequate impairment of assets and auditors not always testing the accuracy and reasonableness of assumptions, inputs and calculations in models, and not properly considering impairment indicators.
  - revenue recognition and auditors did not design appropriate audit procedures and tests to ensure the correct revenue recognition.

  The above were the same areas of concern in the preceding years as stated in Report 774 that it is "concerning that we continue to identify financial reporting findings and audit findings in relation to impairment of assets and revenue recognition." (page 4). They are also ASIC's focus areas for the 2025-26 financial year.

  IPA acknowledges the importance of surveillance in areas that require the application of judgement, such as asset valuation and impairment and revenue recognition. However, Accounting Standards for these areas have not undergone significant changes since they were first issued for application some years ago, and yet these seem to continue to be problematic areas for compliance. Additionally, the stated concerns of the auditors in auditing these areas are fundamental to auditors performing their duties. It is important that ASIC undertakes a root cause analysis of these perceived ongoing areas of non-compliance. For example, are the non-compliances due to systemic application issues caused by unclear Accounting Standards that make the requirements difficult to apply or is it because the entity has chosen to be non-compliant or has been misadvised. Understanding the underlying reasons for the recurring areas of non-compliance will enable ASIC to work with stakeholders such as standard-setters, preparers and auditors to meet its underlying objectives. This is particularly important with the introduction of mandatory sustainability reporting, where the application of judgement, ie use of estimations and forward-looking information disclosures, are more prevalent. In essence, we think ASIC needs to look beyond just surveillance and identify the reasons for the areas of recurring non-compliance so that it or other relevant stakeholders can address them. This would enable ASIC to better achieve the surveillance program objectives to enhance the integrity and quality of financial reporting and auditing, and thereby increasing ASIC's effectiveness in the regulation of RCAs.

Technical expertise
IPA also notes that in recent years, ASIC has committed to increasing its resources and technical expertise of its staff to better carry out the audit surveillance program. We think it is critical that ASIC's staff have the necessary financial reporting, sustainability reporting and assurance technical competencies and experience, especially with mandatory sustainability reporting commencing 1 January 2025. However, this increase in resources appears to not adequately meet the public's perception, which is acknowledged by ASIC. To assist ASIC in ensuring that it is efficient and effective in its regulation of RCAs, we recommend that ASIC reviews its resource capabilities, along with its industry funding model that links the fees levied with the level of ASIC regulatory activities, and increasing the penalties for misconduct. This was stated in IPA's submission to the Financial Regulator Assessment Authority on the Assessment of ASIC (2022) that:

> "Based on the fact that approximately three-quarters of the IPA's members work in or advise small business, we believe that many of these smaller entities are less complex and present a lower (systemic) risk. We note that they do not appear to receive much supervision, surveillance, or enforcement, which make up the bulk of ASIC's costs. Accordingly, the low level of regulatory activity given to this sector, does not justify the level of fees and charges levied upon them."

3. Co-regulation concerns and sharing of information

ASIC states its responsibility relating to RCA is for surveillance, investigation and enforcement. Where ASIC finds the auditor's conduct is deficient, it may:

- impose or vary conditions on the auditor's registration
- agree to an enforceable undertaking or
- refer the matter to the Companies Auditors Disciplinary Board (CADB). The CADB considers ASIC's application and makes a determination and orders on the sanction (if any) on the RCA.

By referring the matter to the CADB for determination, we think the CADB, not ASIC, is performing the role of an enforcer for the misconduct of RCAs. ASIC is essentially more of a regulator than an enforcer. We think, there are merits in reviewing whether the remit of ASIC as a regulator and enforcer should include the role of the CADB.

The current sharing of information on non-compliance by an accountant between ASIC and the Professional Accounting Bodies (PABs) is inadequate. While ASIC has the ability under the ASIC Act and associated regulations to release information to the PABs, the Privacy Act has limited the information flow between ASIC and the PABs. As a work around, some PABs' Disciplinary Tribunal have, as part of the penalties imposed on a non-compliant member, is to impose the condition that the relevant regulators and PABs are notified of a member's misconduct. To properly protect the public's interest, we think that a formal process should be put in place to ensure an individual's misconduct is shared with the relevant regulators (such as ASIC and Tax Practitioners Board) and PABs. A similar approach under the *Tax Agent Services Act 2009*, which enables the Tax Practitioners Board to share the outcome of their investigations with the PABs could be adopted. We understand that ASIC is in the process of formalising the information sharing process with the PABs.

IPA thinks that as co-regulators of auditors' compliance with audit and professional standards, regulation by each 'body' (ASIC and PABs) should be open and transparent and have a spirit of sharing information of interest to related bodies.