

Senior Adviser
Financial System and Services Division
The Treasury
100 Market Street
Sydney NSW 2000

27 November 2015

Capability Review of the Australian Securities and Investments Commission

Dear Sir/Madam

Ernst & Young Australia (**EY**) welcomes the opportunity to offer its views on the capability review of the Australian Securities and Investments Commission.

We support the Government's direction to adopt recommendations from the Financial System Inquiry with the purpose of strengthening transparency, accountability and capabilities of the Australian Securities and Investments Commission (ASIC). However, in our view these changes should be made only after the completion of this capability review.

The capability review is a real opportunity to constructively challenge the existing operating model to strengthen transparency, accountability and the improve capabilities. We have made similar comments in our response to the funding review of ASIC and we believe the prospective introduction of the new funding and user-pays model should be linked to an upgrade in appropriately skilled and experienced resources available to ASIC. Additionally, the performance should be monitored through clear and transparent measures. In our view, it is important that the new funding model should only be implemented in conjunction with a new model for accountability, performance and transparency.

In relation to regulation of auditors, ASIC registers auditors and monitors performance against the AuASB standards through inspection and enforcement programs.

The audit inspection program

The objective of ASIC's audit inspection program is to "*promote high quality external audits of financial reports under Chapter 2M of the Corporations Act and raise the standard of conduct in the auditing profession*". Since commencement, the inspection program has enhanced the focus on audit quality within firms and led to improved processes and practices.

However the current audit inspection program is not without significant issues in terms of timeliness, quality and effectiveness. We have outlined these challenges and some proposed measures to address accountability and transparency below.

Audit quality is not an objectively scientific measurable process, but is the application of professional judgment and interpretation of the AuASB standards applied in the context of the audit of a particular listed entity.

An inspection team's interpretation of AuASB standards may be different to those of the registered audit firm, with very significant consequences for the listed audit client, and the cost and conduct not only of that audit but other audits by the particular firm. The current service, which is proposed to be industry funded, has no mechanism for administrative review of those interpretations, or transparency in relation to ASIC interpretation of AuASB standards across multiple inspections. It is our view that a dispute resolution process should be established to adjudicate and remedy disagreements between an Audit Firm and ASIC as such disagreements result in cost and efficiency drags on participants in Australian capital markets.

We recommend the establishment of a robust quality framework for both the provision of inspections, and suitable administrative review in relation to interpretations and findings, transparency and publication of ASIC outcomes.

Further, we recommend:

- Clear specification and oversight of ASIC's service scope by an independent body in order to increase transparency, accountability, and capabilities of ASIC. In determining the scope, this independent body should engage with the Government to establish key performance measures.
- Annual, published reporting by ASIC against quality key performance targets set by the independent body (including customer satisfaction metrics). The tracking, and reporting, of such metrics will influence behavior and enhance transparency and increase quality performance of the industry funded service. We have provided examples of relevant metrics in the attached Appendix.
- A mechanism to escalate quality or performance concerns to an independent third party, akin to an ombudsman, for the customers of the service.

We would be pleased to discuss our comments further. Please do not hesitate to contact Tony Smith on (08) 8417 1999, Kathy Parsons on (02) 8295 6882, or myself on (03) 9288 8647.

Yours sincerely



Tony Johnson
Chief Executive Officer & Regional Managing Partner Oceania

Appendix

Suggestions to strengthen transparency, accountability and capabilities of ASIC

Oversight by an independent body

In our view, an independent body should have an ASIC oversight role and would determine the scope of ASIC services (in conjunction with broader government budgeting controls and broader goals around an efficient capital market), assess the efficiency and quality of service levels, and set relevant performance metrics.

Key performance targets

To enhance ASIC's accountability and to promote high quality external audits of financial reports, we recommend:

- Clear specification and oversight of ASIC's service scope by an independent body in order to increase transparency, accountability, and capabilities of ASIC. In determining scope this independent body should engage with government to establish budgets with relevant caps on future increases of, for example, CPI minus an efficiency target.
- Annual, published reporting by ASIC against key performance targets set by the independent body (including customer satisfaction metrics). The tracking, and reporting, of such metrics will influence behavior and enhance transparency and increase quality performance of the industry funded service. We have provided examples of relevant metrics below.
- An independent mechanism to escalate quality or performance issues akin to an ombudsman for the customers of the service.

We have outlined below recommended measures to form part of the performance assessment in respect of auditor regulation. As noted above, to achieve transparency performance metrics against agreed performance targets should be determined based on the relevant performance cycle (18 months for audit inspections and annually for fee for service matters) and be made publically available.

Audit Inspection

1. Individual firm inspection reports should be completed prior to release of the public report (Efficiency Measure)
2. ASIC quality review process should be completed within two weeks of finalizing the site visit
3. ASIC should issue draft comment forms on inspections within two weeks to the finalisation of the inspection (Efficiency Measure)
4. Firms to respond to comments forms in timely manner (within two weeks)
5. ASIC should finalise comment forms with two weeks of receiving the firm's response with residual differences referred to the interpretations process (Efficiency Measure)
6. ASIC should perform remote reviews at the same location as the engagement was executed to facilitate an effective review (Efficiency Measure)
7. The ASIC inspection teams for each firm should include at least two individuals who have worked as Registered Company Auditors in the last five years (Quality Measure)
8. The ASIC engagement inspection teams should include individuals at equivalent to Manager audit experience levels. (Quality Measure)

9. The ASIC engagement inspection teams should be lead by a peer equivalent to the engagement partner with comparable level of industry expertise. These lead inspection staff should perform appropriate quality oversight to the inspection. (Quality Measure)
10. Benchmarks should be set outlining maximum weeks spent on an inspection - which would reasonably be relative to the total engagement size / weeks spent on the audit. (Quality and Efficiency measure)
11. X% of interpretation matters referred to independent body (ombudsman style process / panel of peers) determined in a manner consistent with ASIC view (Quality Measure)
12. Interpretation matters resolved with XX timeframe (Efficiency Measure)
13. Total ASIC cost to be recovered under the audit inspection program subject to relevant caps of, for example, CPI minus an efficiency target of X%. (Efficiency Measure)
14. Results from an anonymous/independent service quality assessment process to meet XX benchmark and/or improve XX % over prior years? (Quality Measure)

Auditor Registration and resignation

1. ASIC should process applications with X weeks of receiving the application. Any queries or requests for additional information should be provided with X days. (Efficiency Measure)
2. Processing of auditor resignation forms should be subject to a timing measure (Efficiency Measure)

Audit Enforcement Activities

1. X% of enforcement actions undertaken by ASIC should be successful (Quality Measure)