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Mr Bill Edge  
Chair - Financial Reporting Council  
c/- The Treasury  
Langton Crescent  
Canberra ACT 2600

19 December 2017

Dear Bill

As requested at our meeting held on the 5<sup>th</sup> of December, this letter sets out our observations regarding the recent public comments made by the outgoing ASIC Chairman Mr Greg Medcraft regarding Audit Quality, as well as our perspective on how continuous improvement in Audit Quality is best addressed going forward.

As stated in our meeting, we re-iterate our absolute commitment to performing consistently high quality audits, recognising the critical role that audit firms play in providing confidence to the capital markets. We recognise the important role that ASIC plays in fulfilling its regulatory obligations by inspecting the work undertaken by the audit firms, and the value in firms receiving independent feedback on ways they can improve Audit Quality. We also view ASIC's collaboration with IFIAR as being a positive and important element in ensuring that local regulatory oversight of Audit Quality is appropriately connected to global regulatory focus.

### **Observations regarding Mr Medcraft's Comments**

We, along with many other firms, were surprised by some of the comments made by Mr Medcraft, which do not accord with the good working relationship we have established with ASIC through recent inspection cycles. Whilst we agree that there is still more to be done on improving Audit Quality, it is important to note the following:

- In our view there is an 'expectation gap' around what constitutes poor Audit Quality. Whilst ASIC's inspection finding focus on areas where, in its view, the auditor failed to gather sufficient audit evidence to support the audit opinion, this does not necessarily equate to 'audit failure' in the minds of external stakeholders. In our view directors and investors largely associate 'audit failure' with instances where the auditor failed to detect an issue that lead to a material restatement of reported results (or in the context of a corporate collapse), which is quite different to not allegedly gathering sufficient audit documentation to support the audit opinion.



- The often judgemental nature of the way in which Australian Auditing Standards are applied in practice often leads to a disconnect between ASIC's view of what is a Risk of Material Statement and the firm's view in this regard. It is important that this concept is used by ASIC transparently and consistently, and that there is also an appropriate level of consistency with equivalent definitions applied by global regulators responsible for audit firm inspections.
- Whilst we acknowledge the recent trend in inspection findings, ASIC's inspection selections are publicly acknowledged as being biased towards higher risk or more complex audit engagements, and are therefore not necessarily representative of the broader audit engagement population.
- Reported inspection findings are limited to those areas where ASIC consider there to be an issue with the execution of the audit. Areas which are often seen to be of high value and of critical importance to directors regarding Audit Quality including identification of corrected audit misstatements, reporting of internal control weaknesses, and areas of audit innovation, are not publicly known and/or acknowledged. This is likely adding to the 'expectation gap' referred to above where only 'bad' examples of Audit Quality are publicly called out and not the 'good'.
- Some of Mr Medcraft's comments such as those relating to audit fees and audit firm selection are not consistent with our views. In our experience they are also inconsistent with what directors and investors consider to be relevant in the context of Audit Quality. We consider market forces to be the best mechanism for the monitoring of audit firm appointment and audit fee setting.

At KPMG, we have and are responding to the challenge laid before us to improve Audit Quality. For example, we have invested heavily in Root Cause Analysis processes to help identify, analyse and implement appropriate actions to address findings in key audit quality risk areas. We have also recently appointed a senior partner to the role of Partner in Charge of Audit Quality to help reinforce the "tone at the top" and drive change, and have invested in creating a 'second line of defence' team to independently challenge audit teams on the execution of their audits prior to release of the audit report. Our local and global investment in audit technology and innovation is also significant, including:

- The recent launch of our new audit platform Clara, which provides among other things advanced data analytic technique capability and audit project management tools
- Our global alliance with IBM Watson in order to bring artificial intelligence and machine learning to the audit of complex data sets, improving both Audit Quality and efficiency.

We acknowledge that our Audit Quality systems are not perfect, and Mr Medcraft's comments are a timely reminder that we must continue to improve those systems and reinforce how critical Audit Quality is among our firm leadership, audit partners and



staff. Culture and tone at the top in particular will continue to be a focus area going forward.

### **How is the issue of Audit Quality best addressed going forward?**

In our view a robust ASIC inspection program remains a key element in gaining insight into areas where audit firms require further investment in Audit Quality initiatives. It has proven to be an effective regulatory mechanism to help drive change and Audit Quality continuous improvement at both a firm-wide and audit engagement level.

Further, KPMG, along with the other big accounting firms, is very actively engaged with Doug Niven and his team as we work together to continue to improve audit quality. This includes regular forums in which the firms meet with ASIC to discuss areas of difference in view and to share areas of best practice. A current example is the discussion group Doug Niven has initiated together with representatives from each of the Big Four firms to discuss the appropriate approach to auditing collective provisions under the new AASB9 requirements.

Similarly, audit firms should continue to invest in areas such as Root Cause Analysis, education of partners and staff, and audit innovation including technology to drive continuous improvement in Audit Quality.

Some areas which may warrant further consideration going forward include:

- Identifying an appropriate mechanism or forum to call out 'good' examples of Audit Quality arising from the inspection process, to help address the current imbalance in messaging around firm Audit Quality performance.
- Investigating ways of communicating to relevant stakeholders that Risks of Material Misstatements (as defined by ASIC) do not automatically equate to 'audit failure' as is commonly thought of by directors and investors
- There are a number of company-driven processes that greatly assist the auditor in undertaking a quality audit e.g. appropriate audit project management, use of experienced finance personnel, effective communication protocols with the auditor, and robust financial reporting processes. We would support any initiative that assists in creating further awareness of the importance of this role in the eyes of directors and other stakeholders, and which drives improvement going forward. There may also be merit in obtaining the views of directors and other stakeholders as to what constitutes good audit quality in their minds through a survey or other mechanism, which may help inform any further action required
- Continuing to acknowledge that this is a global challenge, not just a local one. Any proposed changes or development in a local Australian context should have regard to regulatory observations and audit firm responses offshore as considered appropriate, so that global Audit Quality trends are taken into account.



We trust that this letter provides some useful insights for your upcoming correspondence with the Minister. We welcome the opportunity to provide any further detail required, and would be pleased to assist with the FRC's deliberations in any way.

Yours sincerely

s 47F

Gary Wingrove  
Chief Executive Officer

Alison Kitchen  
Australian Chairman

21 December 2017

Mr Bill Edge  
Financial Reporting Council  
The Treasury  
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Via email: [billedge1@gmail.com](mailto:billedge1@gmail.com)

Dear Mr Edge

Thank you for the time you spent with us last week to discuss the recent discussions and press articles relating to audit quality in Australia. We are committed to executing consistently high quality audits supporting confidence in the capital markets. At EY, we are focused on establishing and maintaining an environment that delivers globally consistent and high-quality audits. We have introduced a global sustainable audit quality program with six components focused on improving and maintaining audit quality.

Below we provide an overview of current EY initiatives focused on audit quality, our perspectives on audit quality in the Australian market and our thoughts in respect of appropriate next steps.

#### **Current EY initiatives focused on Audit Quality**

In 2015 EY globally launched our Sustainable Audit Quality (SAQ) Program to achieve increased quality and consistency in audit execution. Following implementation of SAQ, our global internal and external quality inspection results have improved, with Australian internal inspection results significantly improving in 2017 (greater than 20% increase in positive file review outcomes).

As we discussed there is a lag effect in realising the benefits of quality initiatives and in our view there has been improvement in audit quality since the last reported ASIC inspection results as a result of the SAQ actions taken by the firm. The last ASIC inspection was completed in December 2016 and primarily related to audits conducted in 2015 and earlier with less than 20% of files relating to 30 June 2016 audits.

Implementation of SAQ represents a significant investment for EY, a cultural shift to embed audit quality through changes to systems, people and structures. The six components of SAQ (detailed below) are Tone at the Top, Strengthen People Capabilities, Audit Technology and Digital, Enablement and Quality Support, Simplification and Accountability.

**Tone at the Top**, internal leadership messages and commitment to quality are driven by EY globally through Asia Pac and by leadership in Australia. This is the most important element of continuously building our culture of audit quality. An example of our commitment to maintaining the right tone is the Oceania Assurance leader's personal attendance and involvement in executive audit training in all locations at least once per year.

**Strengthen People Capabilities**, investment in resources to support our auditors in performing quality work. Over the past two years we have increased our technical accounting and audit quality support resources adding an additional three partners and seven directors and managers. Additionally our workforce now has different skills including analytics and innovative project management.

**Audit Technology and Digital Investment**, improve the audit process using the latest tools. We deployed EY Canvas, our online audit platform that integrates and embeds our methodology, engagement documentation, project management and client interfaces. We have also developed EY Canvas Client Portal and EY Helix data analytics and robotic process automation (RPA) tools which are now deployed on our largest most complex engagements and will be extended to all engagements deriving increased audit quality through analysis of 100% of transactions.

**Enablement and Quality Support**, assist our engagement teams to consistently deliver quality audits. Enablement includes creating a global network of seasoned professionals as our Quality Enablement Leaders, implementing our Milestones project management program (setting completion targets and monitoring stages of completion of individual engagements), establishing a warm review program to conduct quality reviews concurrent with the execution of the audit and deploying a Root Cause Assessment and response program.

**Simplification**, simplify and standardise our methodology, forms, templates and checklists. This influenced the design of EY Canvas and EY Helix data to improve the quality through consistency in documentation.

**Accountability**, increased correlation between audit quality and partner remuneration. Annual partner quality performance assessments are central to partner performance assessment and directly impact individual partner remuneration. Quality indicators considered include internal and external inspection outcomes, compliance with firm policies regarding consultation and setting the right tone in relation to audit quality.

Our SAQ program underpins our audit quality action plan which provides detailed actions against each initiative. The detailed action plan and outcomes is reviewed with ASIC on a regular basis. Whilst we are pleased with the results of the program to date, we continue to work to further improve the quality of our audits. I would be happy to share further details on SAQ as appropriate.

### **Perspectives on audit quality in the Australian market**

In our view, an assessment of the current status of audit quality in Australia is more complex than some of the current press commentary which has focussed solely on the metrics of ASIC inspection outcomes. Quality audits contribute to confidence in capital markets, and ASIC inspection metrics should be interpreted together with a range of other indicators of audit quality in the context of Australia's capital markets, including:

- Low incidence of corporate failure associated with financial reporting in Australia. This provides some support that the audit process is operating as an effective component of capital market oversight.
- Very few occurrences of financial statement restatement rates following change of audit firm. Changes to auditors have not resulted in financial statement restatements suggesting effective audit processes.
- Recent corporate practices have become more rigorous including an increase in the consistency of preparation and the quality of management financial analysis and position papers provided to Audit Committees over the past 5-10 years. This improvement is in large part a response to increased Audit Committee communications by auditors and an increase in process rigour of Audit Committee Chairs to assess the underlying quality of financial reporting. Chairs have become more responsive to auditor views on the importance of appropriate internal controls and are increasingly focused on engaging with management to improve the controls framework underlying the financial statement reporting processes.

- Audits regularly identify adjustments that are required to be made to financial statements before being released to the market. A study in Singapore relating to 2013 financial statements identified that 3000 audit adjustments were proposed over 257 entities reflecting the value of audits in the capital markets.

In respect of current ASIC initiatives to improve audit quality, we support the collaborative attitude adopted by ASIC and value the strong working relationship we have and the perspectives that are brought by many senior ASIC personnel which assist in enhancing audit quality.

In relation to the ASIC inspection program we would make the following observations.

The current program is heavily weighted towards individual file inspections whereas other international regulators often spend a greater portion of time on the broader firm quality processes and methodologies. The rationale of those regulators is to ensure the processes that drive quality are in place across the firms – impacting all audit professionals and all engagements. We note that ASIC's 2016/17 inspection cycle included a review of firms' quality assessment processes and that they intend to review project management and root cause processes at firms in the near future. However, we believe a greater weighting of ASIC's resources on reviewing quality controls systems across a large number of firms could improve audit by focusing on matters that impact all auditors – rather than a risk based sample.

Regulators in other jurisdictions employ significantly higher skilled staff than ASIC for audit quality inspections, typically ex senior managers and partners of the large firms. This deeper and wider experience with the audit context may better place those regulators to discharge the quality oversight role in relation to audits. We are very supportive of ASIC's proposed strategy to use former audit partners and support the use of funding from the user pays process to enhance the experience within ASICs inspection teams.

### **Next Steps**

In addition to the continuing investment of the firms, including EY, we would also make the following suggestions to further improve audit quality and ensure confidence in the capital markets is not eroded.

- Broader engagement with the director community on the importance of the audit to the capital markets and the role that directors play in enhancing audit quality. Further engagement by ASIC, accounting bodies and the individual firms with a consistent message to Audit Committees that continues to highlight the importance of high quality audit execution could also encourage measurement of audit performance as part of corporate governance.
- Developing broader measures of audit quality in addition to ASIC inspection outcome metrics. In addition to the measures above this could include an Audit Committee Chairs survey relating to their perspective on audit quality – including their views on the extent to which the audit process is resulting in improved internal finances processes and rigour, and the attitude of audit committees to unadjusted audit differences.
- Improved communication of the context of regulatory findings to avoid generalisations of inspection outcomes. In particular:
  - ASIC's file selection process for inspection is risk focused and therefore not representative of audits generally. Inspection metrics cannot therefore be extrapolated as measures of audit quality in the overall market, and such extrapolation by regulator or by press may undermine capital markets confidence.

- ASIC's determination of "restatements" from enquires following the financial statement inspection program (ASIC recently quoted a 4% restatement rate) are not based on restatements in financial statements. In many instances associated directors and auditors do not agree with ASIC's position and would view the item as a period event (it is important for director confidence in the regulator and associated capital markets confidence that there is greater transparency in this process).

In relation to the ASIC inspection process we support current initiatives to improve the experience of the inspection staff by involving recently retired audit partners and we would further support initiatives, such as secondments from audit firms to the regulator, to increase the sharing of expertise and perspectives between the regulator and the audit firms.

I would welcome the opportunity to discuss any of the above matters in more detail and look forward to our ongoing proactive and diligent involvement and focus in improving audit quality.

Yours sincerely

s 47F



Tony Johnson  
CEO and Regional Managing Partner Oceania



5 December 2017

Mr Bill Edge  
Chair  
Financial Reporting Council  
c/-The Treasury  
Langton Crescent  
Canberra  
ACT 2600

Dear Mr Edge

## **Audit Quality in Australia**

We refer to your letter dated 21 November 2017 in which you stated that you were seeking our firm's engagement on audit quality and to discuss the ASIC inspection findings and our response.

We believe that the ASIC inspection process serves an important role in improving audit quality for the benefit of investors and the public interest. We will continue to work co-operatively with ASIC to improve audit quality. Executing high quality audits is a priority for our Global Network and our firm.

We strongly believe that the investments we have made and are continuing to make in innovation and emerging technologies, our audit processes and policies, and our system of quality control are enhancing the quality of our audits.

The most recent inspection results indicate that audit quality in our firm has deteriorated slightly as it has in the wider profession. Whilst we accept the need for continual improvement we strongly believe that in the last three years (covering the previous two inspection cycles) that audit quality in Deloitte has improved. In our view, the nature of the issues raised by ASIC to us three years ago were more serious than the issues raised in the most recent inspection cycle.

Our Global Network has had improving audit quality as our main priority for a number of years significantly investing in methodology enhancements to ensure global consistency of our approach to audits as well as strengthening key elements of our system of quality control.

We are absolutely aligned with the regulator on wanting audit quality to continuously improve and in this regard we are unquestionably aligned. From a mindset perspective, we have committed to an "agree and accept" approach which we understand is unique to Deloitte. Whilst at times we might see a different path to improving audit quality, when the regulator has a reasonable view, we will accept those views as part of our overall strategy to improve quality.

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These efforts collectively have resulted in improvements in the results of PCOAB inspections in the US, the UK, and globally. Furthermore, there is a strong focus at a global level on achieving the target of a 25% reduction in inspection findings as committed to IFIAR, which Deloitte globally is on track to deliver.

The investments that we have made in innovation and emerging technologies, our audit processes and policies, and our system of quality control have included:

- Rewarding partners for good quality (we have penalised partners for poor quality for a number of years).
- Deploying a crowd support tool for audit practitioners to ask and answer questions in the field ensuring teams get the right answers when they need them.
- Implementation of a query management system (QMS) to enable and consistently document and evidence consultations both on audit approach and on accounting technical matters.
- Release of partner quality dashboards (a snapshot of the partner's current active engagements).
- Establishing the Technology and Controls team.
- Introduction of Centres of Excellence in certain audit areas such as cash and payroll.
- Establishing taskforces (e.g. to respond to findings in Impairment and Internal Controls).
- Roll out of global enhancements to our audit technology and methodology (EMS). In 2016, holding a two day partner bootcamp to redefine expectations in relation to the use of EMS and partners' role in executing quality audits.
- Enhancing our monitoring programs
  - Introduction of inflight monitoring on live engagements, this has included
    - ASX 200 coaching
    - Healthchecks
    - Use of file diagnostics.
  - Enhancements of the Global Practice Review program
    - A move to risk based selections
    - 100% increase in time spent on file reviews
    - Moderation panels to rate each file reviewed and ensure consistency
    - Increased rigour of testing of the system of quality control
    - Performing casual factor analysis, looking at the root cause of findings both positive and negative.
- Establishing review panel requirements for all audit reports containing key audit matters.
- Developing new lateral hire training and on-boarding.
- Influencing Deloitte Global, as member of the Audit Quality Board, the Audit Technical Advisory Board, the Audit Quality Monitoring and Measurement group and as external partner for the practice review of another member firm.

Our current audit quality plan has an immediate focus on:

- Testing of Information Produced by the Entity
- Completeness of archived files
- Journal entry testing
- Development and implementation of Operating Unit Leader dashboards
- Documentation of elements of the system of quality control
- Enhancing our risk sensing.

As we have noted, we believe that the inspection process serves an important role in improving audit quality. We accept the need to improve audit quality in our firm and we believe improvements can be made by other stakeholders, including ASIC. We would like to take this opportunity to make the following observations on the current inspection process:

- In total a relatively small number of file reviews are undertaken in the context the total public interest entity population. ASIC continues to focus on file reviews whilst other regulators are focussing on testing the system of quality control.
- A number of the reviewers lack practical audit experience which challenges our “agree” or “accept” mindset for example:
  - A number did not reach senior levels in the profession;
  - Some do not have appropriate industry experience; and,
  - Some have limited knowledge of controls based auditing.
- The time taken to conclude file reviews can be stop / start and cause significant strain on our partners and staff.
- We have had instances where ASIC has conducted financial reporting surveillance on an entity and has not closed out their queries with the entity. Subsequently, the ASIC individual who looked at the matter in surveillance was assigned to review the audit work on the matter. In these instances they clearly had a conflict of interest and came to the review with bias.
- ASIC is concluding in some audit inspections that matters are misstated, however have not gone back to the entity to seek a restatement despite having information from the entity many months before the audit file was inspected.
- There is a need to think about succession planning within ASIC to ensure the long term success of the inspection program.

Whilst we have raised these issues previously with ASIC, they will form the basis of an agenda for a meeting with the incoming chairman of ASIC in the new year.

As we stated in our responses to the Industry Funding model, one of the recommendations of the ASIC Capability Review was to remove ASIC from the Public Service Act 1999 (PSA) as a matter of priority to support more effective recruitment and retention strategies. In its response to the ASIC Capability review findings, on 20 April 2016, the Government agreed with this recommendation, however has not yet implemented this change. We would welcome the opportunity to explore different operating models for ASIC to ensure the sustainability of a robust inspection program and address the observations made above.

In conclusion, as you have noted in your letter, audit quality will be enhanced when there is collaboration between the regulator, the firms, companies, users, accounting bodies and standard setters.

We are committed to improving audit quality and to maintaining investor confidence in the information contained in financial reports.

Yours sincerely

s 47F

Cindy Hook  
Chief Executive Officer

s 47F

Tom Imbesi  
Chairman



Mr Bill Edge  
Chair  
Financial Reporting Council  
C/- The Treasury  
Langton Crescent  
CANBERRA ACT 2600

18 December 2017

Dear Bill

**Subject: Audit Quality**

Thank you for your letter dated 21 November 2017 and for your time to meet with Mark Haberlin, Matt Graham and me on 5 December 2017. As requested, this letter outlines some perspectives on the current public discourse regarding audit quality in Australia. It also covers some suggestions for proposed actions and commitments from PwC to play a leading role amongst the industry as we work to continuously improve audit quality.

**The importance of audit quality to Australia's capital markets**

A high quality audit industry is fundamental to the effective operation of Australia's capital markets. In a world where trust is harder and harder to earn, the importance of credible financial, and other, information as the basis for shareholders to make investment decisions has arguably never been higher. There is a need for auditors, companies and regulators to work together to ensure that all aspects of audit quality are continuously improving and that we all play our role to maintain and enhance investor confidence.

**PwC's views on recent public commentary**

We note that the most recent public report released by ASIC announced a deterioration in audit quality across the industry according to ASIC's measure of audit quality (ASIC inspection findings). As ASIC have since noted, whilst this trend is not consistent with global reductions in similar measures in other territories in the same period, it does require more action than has been the case to date.

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Public references from ASIC to the situation as "appalling" and "[it will] cause another Enron" were, in our view, inflammatory and not consistent with the legislated objectives of ASIC to enhance confidence in capital markets. That said, PwC recognises the need to continue to increase efforts to improve audit quality across the industry. In that spirit, this letter includes suggestions/commitments in three areas:

1. Suggestions from "what has worked well" for PwC
2. Suggestions for improvement to ASIC's inspection process
3. Commitments from PwC to play a leading role in continuous improvement in 2018 and beyond

#### **1. Suggestions from "what has worked well" for PwC**

PwC's external ASIC inspection findings have remained constant in a range of 12-14% over the last two ASIC reports (compared to an industry average of 24% for the Big 4 firms). Whilst we maintain a relentless focus on continuing to improve, we attribute our ability to reduce audit quality findings in the last 4-5 years to:

- The lifting in the profile of audit quality in the Assurance strategy and communications from leadership
- The holding of an Audit Quality Summit in 2013 for every PwC Assurance Partner, which set a new compulsory behaviour for Partners and their engagement with teams, mandating that they must be "at the client, with the team, in the file"
- The introduction of a thorough Real-Time Review process where independent file reviews are performed prior to finalisation of files for listed companies
- A detailed Root cause analysis process across all findings from external and internal inspections. For example this provided strong evidence that our highest quality audits were our best planned audits, and vice versa
- Introduction of a clear and significant Accountability framework for Engagement Leaders and Partners in leadership positions
- The use of emerging technology to drive standardisation and automation, thereby improving consistency of outcome. For example, PwC globally has invested over USD\$200m in our audit software "Aura" - with the same version of the same software now on every laptop of every PwC Assurance practitioner around the world.

These initiatives have also resulted in a reduction in adverse findings from PwC's global internal file inspection process over the last 3 years.



## **2. Suggestions for improvement to ASIC's inspection process**

In the spirit of improving the process by which ASIC's external inspection findings come about and are communicated, we recommend the following suggestions, each of which have been raised with ASIC directly:

- ASIC should release public reports for each individual audit firm they review. Trust can only be built with transparency. Transparency drives personal accountability amongst leaders. At present, the confusion surrounding industry averages and sample selection results in a situation where the full story of where audit quality issues exist is not transparent.
- ASIC shorten their inspection period from 18 months to 12 months to align with global regulators to improve ease of understanding of outcomes
- ASIC consider change to their sampling process. ASIC currently intentionally review the riskiest areas of the riskiest audits. Whilst in an environment of limited financial resource this makes sense, the extrapolation of results across this small risk-based sample across the entire capital markets is inaccurate and erodes confidence in capital markets when used for public reporting purposes
- ASIC consider other measures of audit quality to sit beside file inspection findings. For example, the percentage of restatements to financial reports or the number of corporate collapses following "unqualified" audit opinions. For example, ASIC have shared that in the last survey period, only 4% of companies had restatements to financial statements as a result of financial report surveillance or audit inspections.
- Given that ASIC's audit inspection program is now funded by the industry under the "user pays" model, ASIC should establish an accountability framework for its inspection process that sets standards for the market such as what its turnaround time will be on reports, quality of ASIC staff and quality of ASIC reporting.

## **3. Commitments from PwC to play a leading role in continuous improvement in 2018 and beyond**

PwC recognises the need for improvement in audit quality and the resulting need to improve investor confidence in the audit industry. We also recognise that our role as the largest professional services firm in Australia brings with it a responsibility to lead the industry.

In February 2018, I have personally convened a meeting of Australia's Big 4 CEOs to discuss the leadership importance of this topic and the need for us to work together to solve the issues that exist. That will lead to several initiatives between the firms that will include the sharing of best practice with each other, identifying industry wide root causes and improving industry interactions with other stakeholders in the market.



PwC will also continue to be an active participant in other industry actions and forums, including the current projects on Audit Committee Chair surveys, Root Cause analysis and Accountability framework and the CAANZ-led market-wide Roundtable series. Matt Graham (Assurance Leader) and Regina Fikkers (Regulatory Affairs Leader) have personal responsibility for these efforts.

Finally, PwC will continue to address audit quality as a priority in our Assurance strategy, with a continuous improvement mindset, in an effort to drive further reductions in PwC's external inspection findings.

Bill, as we've discussed, this is an important conversation for Australian capital markets and there is work to do for our industry. You have my commitment that PwC will play a leadership role as we work together with other industry participants in 2018 and beyond.

Yours sincerely

s 47F



Luke Sayers  
Chief Executive Officer



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AUSTRALIA + NEW ZEALAND

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19 December 2017

Mr Bill Edge  
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Via email: [frsecretariat@treasury.gov.au](mailto:frsecretariat@treasury.gov.au)

Dear Bill

### Financial Reporting Council engagement on audit quality

Thank you for your letter of 21 November and our meeting on 18 December. As I noted at our meeting, Chartered Accountants ANZ is, and has always been, engaged in the importance of maintaining investor confidence in the information presented in financial reports. This engagement covers both the preparation of the financial statements and the audit of these statements.

A demonstration of this commitment is the fact that we have maintained senior individuals as leaders for both Financial Reporting and Audit. These individuals proactively engage with stakeholders and members, develop policy positions and provide input into the design of standards and regulation to drive enhancements in these areas.

We were particularly disappointed with the public comments of the former ASIC Chairman which you quote in your letter. We have been working with ASIC for many years and believed we were part of a collaborative approach to addressing issues arising from ASIC audit firm inspections. This has included:

- providing ASIC with a platform at each of CA ANZ's annual Audit Conferences to explain and highlight issues they wish our members to address
- publishing Assurance Essentials twice a year setting out ASIC concerns and providing reference to materials to assist appropriate application of standards in the areas listed
- working with ASIC through the Australian Public Policy Committee, which has included specific meetings with the firms and ASIC to find common ground on the application of standards where there have been differences of opinion
- attending quarterly formal liaison meetings with ASIC and undertaking separate interaction on specific issues.

In keeping with our commitment to recognise the importance of the role of the external financial statement audit process in maintaining investor confidence, we continue to seek a collaborative approach with all relevant parties.

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In early December, we hosted a roundtable of senior representatives from the audit profession, business and regulators to discuss the quality, integrity and future of audit in Australia. This was partly in response to the negative public commentary, but mainly to consolidate and reaffirm the productive discussions already taking place between various stakeholders. ASIC were represented at the roundtable and all participants confirmed support for working in partnership to maintain a strong audit profession and uphold audit quality.

This commitment is being continued by ongoing initiatives by us and others in the profession into root cause analysis, audit partner accountability, and audit committee involvement in audit quality.

### **Audit quality**

One of the points we have sought to address is whether the quality of the audits undertaken in Australia is lacking. The comments by the former ASIC Chairman were based on an ASIC inspection report which was issued in June 2017 and which related to audits of financial statements ending 31 December 2014 to 30 June 2016. The ASIC inspection program selects a few particular areas of an audit file relating to the financial statements. It is an important program and a good source of data relating to compliance in these areas. However an audit is more than compliance with a list of procedures.

There has been substantial consultation by the IAASB internationally on elements of an audit which are necessary in order for an audit to enhance the reliability of financial statements and provide assurance of that reliability to users. These elements are:

1. Inputs
2. Processes
3. Outputs
4. Key Interactions within the Financial Reporting Supply Chain
5. Contextual Factors

Chartered Accountants ANZ have been undertaking actions to address the issue of audit quality in terms of each of these elements and we set out in the appendix to this letter, examples of such activities.

We also note that Treasury undertook a review into audit quality in Australia in 2010 and concluded that the Australia framework was robust and there was credible evidence that audit quality is taken seriously. We believe these comments remain appropriate.

I look forward to continuing our engagement on these matters.

Yours sincerely

s 47F

**Rick Ellis**

Chief Executive Office

Chartered Accountants Australia and New Zealand

## Appendix

### 1. Inputs: The culture within an audit firm

This covers such matters as the core values of the audit firm, the ethics and attitudes of the individuals within the audit practice.

In order to monitor activity in these areas, in 2011-2012 we undertook an Audit Quality Research Survey which involved researching the mindset of auditors and assessing perceptions around the key drivers of audit quality in the major firms. This innovative initiative continued during 2013-2014 with a further six major firms completing the survey. Overall over 6,000 auditors from graduate to partner were involved.

The research findings were provided to the individual firms, benchmarked against masked data for the other participating firms. This provided them with valuable information, enabling them to identify and understand the mindsets and attitudes of their audit partners and staff as the basis for improving audit quality. The firms used the data for root cause analysis to focus on areas for enhancement and to direct their action plans.

The overall findings show a strong commitment to audit quality among firms with varying challenges in promoting the consistent application of culture and policies.

Findings were complemented by Audit Quality Forums held in May 2014 for senior partners from the 11 firms who participated in the research. Participants considered wide ranging audit quality matters including options to support audit quality by individual firms and across the audit profession.

In order to emphasise the importance of matters arising, and promote quality initiatives among our membership more generally, summarised findings from the research were released in the form of an audit quality research infographic.

## AUDIT QUALITY RESEARCH

Over the past couple of years the Institute of Chartered Accountants Australia has conducted innovative research into the perceptions by audit partners and staff of the main drivers of audit quality in major accounting firms in Australia.

**11** AUSTRALIAN NETWORK AUDIT FIRMS HAVE PARTICIPATED IN THE RESEARCH  
OVER **6,000** PARTNERS AND STAFF

### DRIVERS OF AUDIT QUALITY:

- CULTURE WITHIN A FIRM
- SKILLS AND PERSONAL QUALITIES OF PARTNERS AND STAFF
- EFFECTIVENESS OF THE AUDIT PROCESS
- FACTORS OUTSIDE THE CONTROL OF AUDITORS
- USEFULNESS OF AUDIT REPORTING

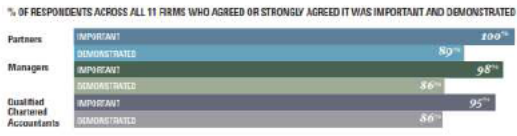
Overall, findings show a strong commitment to audit quality among firms with varying challenges in consistently applying policies. For example, there are concerning variances between the responses of partners and staff, in particular on the effectiveness of audit procedures and the 'tone at the top'.

The firms are using the data for root cause analysis to focus on areas for enhancement. Firms in the earliest round of research have progressed this through action plans. The institute continues to work with firms to support and promote developments.

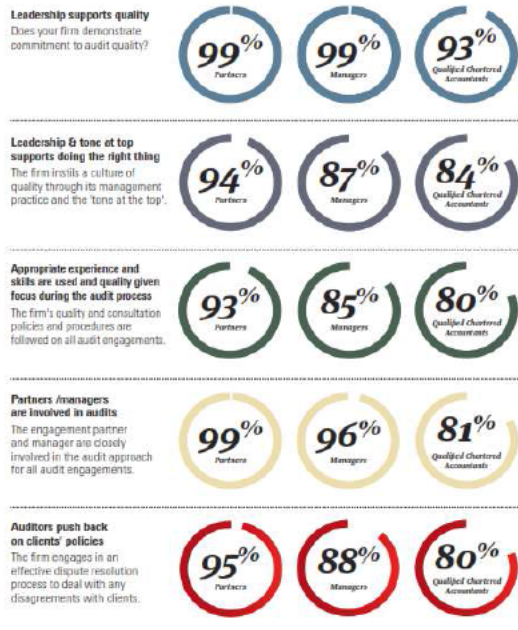
Some of the main themes of the research are highlighted in this infographic and have also been shared in the publications, *Preserving capital market confidence through audit quality* and *Sharing experiences on audit quality*.

### Professional scepticism seen to be important AND being demonstrated

To what extent is professional scepticism important in your role and to what extent do engagement teams demonstrate this attribute?



### % OF RESPONDENTS ACROSS ALL 11 FIRMS WHO AGREED OR STRONGLY AGREED



The percentage figures are weighted averages based on the number of responses from each firm.



## 2. Process: The effectiveness of the audit process

This covers the rigour of the audit process, methodology and quality control procedures.

### Professional scepticism

Chartered Accountants ANZ recognises that professional scepticism is a key component of an effective audit process. We have placed great focus on ensuring this topic is in the forefront of our communications and that relevant tools are available. This includes:

- ***Practical Ways to Improve the Exercise and Documentation of Professional Scepticism in an ISA Audit.*** A guide which provides a reference tool when considering how to demonstrate that professional scepticism has been exercised throughout the audit.
- ***Professional Scepticism under the microscope*** training
- ***Fraud Stories.*** A series of short clips of auditors sharing their stories of encountering and addressing fraud situations in an audit.
- ***Academic study.*** A study on how firms conceptualise and apply professional scepticism in an audit context.
- ***The Art of Professional Scepticism.*** A five-part guide series designed to help junior auditors apply professional scepticism, build client relationships and ask questions.
- ***Experiential online training program.*** Online training designed for audit leaders, providing case study exercises supported by academic research, on applying professional scepticism in audit situations and coaching teams to develop professionally sceptical behaviours.

### Audit process

We also have prepared and communicated a number of resources specifically targeted at audit processes which have been highlighted as concerns by ASIC, our review processes, or other discussions with members and stakeholders. These include:

- ***Sharing experiences in audit quality.*** A publication which set out practical and tested processes and initiatives for improving audit quality. These were drawn from the Audit Quality Action plans of the six major firms, who shared their plans with Chartered Accountants ANZ for the purposes of identifying options appropriate for smaller firms.
- A video of a discussion held between the ***CA ANZ CEO and Greg Medcraft of ASIC on Audit Quality.***
- Resources to assist firms set up an effective quality control system through the ***Quality Control Guide*** and the ***Quality Review Questionnaires.***
- Twice yearly ***Assurance Essentials*** and ***Reporting Essentials*** updates. These provide a brief summary of new standards and requirements, together with details of tools and guidance available to help with the application of the standards.
- Perspective articles which are longer form articles on particular technical topics. Topics have included the ***Revenue Standard, How to tell your story, Are ISAs suitable for small audits? Transparency reporting, Enhancing audit quality, Audits of small entities, and Enhanced auditor reporting***

- Maintaining and updating our ***Audit Manual and Toolkit for Small and Medium Sized Entities*** to provide practical assistance for applying standards and undertaking quality work. The manual provides detail of requirements and standards, guidance on practical implementation through case studies and incorporates a toolkit providing methodology tools for specific areas. It is also used as a basis for a widely used commercial software programme. It provides an important way to get audit quality messages to a large number of members through practical assistance.
- Maintaining regular, relevant communications on audit quality matters through our fortnightly electronic newsletter ***Reporting and Assurance News***. This provides regular and easy updates on changes to standards and regulations and upcoming areas of focus.
- ***Review of Transparency Reports*** (2015) paper highlighting quality control elements being reported on by audit firms undertaking more than 10 listed entity audit engagements.
- The ***Audit Guide and Toolkit for Self Managed Superannuation Funds*** providing practical guidance on auditing requirements, reporting and documentation developments to ensure members are aware of and comply with legislative and professional requirements relating to SMSFs.
- ***Independence Guide***. A paper highlighting practical examples, FAQs and other material on the application of the Code of Ethics and independence rules for SMPs.
- ***Technical enquiry service*** to assist and support members resolve technical issues.

## Training

We run a strong CA Program that is responsive to changing expectations. The CA Program is recognised as a Graduate Diploma of Chartered Accounting (GradDipCA), an AQF accredited postgraduate qualification and is recognised internationally through the IFAC program. Post qualification training and face to face activities reinforce the importance quality issues and we have developed a variety of online, on-demand training options on audit issues. Over the past few years, these training offerings have included:

- Auditing Micro-Entities
- Top 10 Tips for Audit
- Audit of SMSFs Series
- Fraud Issues Workshops
- Practical Auditor Series (covering materiality and auditing asset values and impairments)
- ASIC-run Registration as an Registered Company Auditor
- Risk Based Audit Series
- Auditor Essentials Series
- Audit Leaders Series
- Registered Clubs
- Auditor Reporting Issues
- Auditing the SME Business
- Auditor Toolbox

We run annual Audit and Accounting Conferences in most states. ASIC have presented on their audit quality issues at these conferences. Other sessions have included feedback on findings from our Quality Review Programme, practical sessions on applying the sampling and estimates standards, focus on professional scepticism, and audit risk assessments. Members are required to undertake CPD in audit if that is their specialised area.

## Member engagement

We also sponsor and run discussion groups and presentations nationwide to encourage and promote interaction between members in audit and to promote audit quality.

- Present 'Sharing Knowledge' sessions undertaken in each state
- Attend and promote discussion at small practitioner groups in Melbourne and Sydney

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- Attend and present at mid-tier organised conferences and firm-specific conferences
- Hold ongoing discussions with firms and stakeholders on the application of standards, sharing experiences and highlighting expectations on matters relating to the conduct of audits

### Monitoring and maintaining quality of members' work

The quality of work undertaken by our members in public practice is monitored through our Quality Review Programme. Each year a selection of practices that provide public accountancy services, including audits under the Corporations Act and non-Corporations Act, are visited and specific engagements are inspected. Those that have areas of non-compliance are required to develop an action plan within two months of the results, outlining how they will address the issues, and to undergo a follow-up review within 12 months.

Where an action plan is not provided or adequately implemented at the time of the follow-up review, a practice may be referred for investigation by the Professional Conduct team. This has not yet been necessary.

Chartered Accountants ANZ is responsible for disciplining members who breach the By-Laws and Regulations of Chartered Accountants ANZ as well as APES 110: *Code of Ethics for Professional Accountants*. Complaints and other potential conduct matters are investigated and may be referred to the Professional Conduct Tribunal for independent hearing. The professional conduct function was restructured in 2014, following an independent review of process. This restructure introduced:

- an independent Professional Conduct Oversight Committee
- a Professional Conduct Committee, responsible for assessing complaints and other matters, assessing whether or not the matter should proceed to the Tribunal for hearing and entering into consent agreements with members in appropriate cases
- the appointment of an experienced independent lawyer to advise the Tribunal as required on legal issues.

### 3. Outputs: The reliability and usefulness of the audit reporting

This covers such matters as the scope of the audit, key judgements and feedback to the committee, and how the auditor reports on the financial statements as well as other reports such as transparency reports, or reports to those charged with governance.

Activities we have undertaken to support the process and collection of evidence to support the audit opinion is covered in the previous section. In addition we were instrumental in engaging business and investors in understanding of the impact of the new style auditor's report. This has included:

- **Webinar on new auditor reporting requirements**
- **Video interview with the Chairman of the IAASB on the new reporting requirements**
- **KAM: The Matters That Matter.** Key audit matters guidance specifically for SMPs, providing practical assistance on how to identify and write key audit matters and working with their clients
- **Auditor Reporting Roundtables**
- **The Future of Audit Reporting.** An on demand webinar on practical ways to apply the new auditor reporting suite of standards.

### 4. Key Interactions within the Financial Reporting Supply Chain

This covers such matters as the entity's resources, qualifications and level of experience for preparing financial statements, and interactions with others in the financial reporting supply chain.

An audit is a collection of evidence. This evidence is collected from a variety of sources and is iterative. Most, if not all, of the elements of audit quality relate to processes and behaviours which are not easily visible. The Audit Committee is in the prime position to assess quality. The Audit Committee has access to, and responsibility for the oversight of, the external audit process. Similarly they have access to company matters through their role on the Board and so understand the business and operations of the entity, how that translates in the financial statements and therefore how the audit addresses the specific circumstances of the entity.

Audit Committee members have the authority and means to review and question the audit role, and to assess the audit communications in the context of the entity. Further, as independent non-executive directors, they do not have direct interests in the management of the entity and so can provide an objective overview bringing the shareholders' interests to bear. We hold regular meetings with director representatives to understand and share issues arising in relation to audit and reporting matters. We have also written for the AICD member magazine and developed a publication ***Directors' Responsibilities for Financial Reporting***

## 5. Contextual Factors

These are the environment factors which have the potential to impact the nature and quality of financial reporting and audit quality, such as laws and regulations relevant to financial reporting and audit and talent availability.

Chartered Accountants ANZ continues to contribute to debates globally and domestically designed to enhance the understanding and rigour of the frameworks in which audit quality applies. This has included input into International Auditing and Assurance Standards Board, Centre for Audit Quality, and PCOAB activities and consultations on audit quality matters, such as the Audit Quality Framework, and Auditor Reporting projects.

Domestically we funded research into the way financial reporting and audit and auditor qualifications are established by Australian legislation. This research highlighted over 100 pieces of state or federal legislation requiring an auditor and a substantial range of descriptions for the work and qualification requirements. This complex environment can impact audit quality in direct and indirect ways.

We contributed to the revision of the ***Auditing Competency Standard for Registered Company Auditors (RCA)*** which provides an alternative to meeting the hours of experience requirements for registration with ASIC as an RCA.

We funded research into perceptions of audit as a career as students' progress through university and the CA Program. This research took a deeper look at issues around audit quality and impact on students and young accountants. The results were shared as an infographic summarising influences on young people to take up an auditing career.

We have supported and promoted the ***#AuditorProud*** campaign for the last three years.



21 December 2017

Bill Edge  
Chair  
Financial Reporting Council  
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Canberra ACT 2600

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Via email: [frcsecretariat@treasury.gov.au](mailto:frcsecretariat@treasury.gov.au)

Dear Bill

I am writing to respond to the audit quality issues raised in our meeting on 11 December 2017 as well as your letter of 21 November 2017 seeking CPA Australia's engagement on audit quality and maintaining investor confidence in the information presented in financial reports.

You have specifically requested details of actions undertaken by CPA Australia to address the issue of audit quality to inform your update to the Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP.

CPA Australia is supportive of a collaborative approach to addressing audit quality, involving all stakeholders in the financial reporting chain including preparers, auditors, regulators, users, accounting bodies and standard setters.

A collaborative, multi-stakeholder approach is necessary as there are no universally accepted measures of audit quality which can be used to reliably and consistently compare audit quality between engagements, firms or countries and between periods so that the impact of actions can be easily monitored and their effectiveness assessed.

To be effective, actions need to address the drivers of audit quality. *ASQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagement* identifies the following elements which need to be addressed in a firm's system of quality control: Leadership responsibilities for quality within the firm, relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, human resources, engagement performance and monitoring.

We outline below the actions we are taking and the ways in which we are currently collaborating with stakeholders to positively impact audit quality.

## **Actions:**

### **1. Quality Reviews**

#### **CPA Australia reviews**

Quality reviews of our public practitioners are conducted by peers who practice in similar service areas, which are trained, overseen and reviewed by CPA Australia staff. All practice areas of a public practitioner are reviewed, not just audit services provided. CPA Australia members who are Registered Company or SMSF auditors are subject to quality review every three years. Members are assessed for compliance with the Ethical and Professional Standards and the Auditing and Assurance Standards. Members who have breaches in their initial review are reviewed again 12-months later.

The review program has continued to evolve to more actively manage members who have repeated breaches of auditing and quality control standards and so now if audit breaches are found in the same areas on the second review, they are referred to professional conduct. We seek to manage members on a case by case basis between reviews and in this way are able to provide increased focus on audit quality issues and support members who are unable to meet the prescribed standards to stop providing auditing services.

We share breaches and observations from the quality review program with members annually:

[Top ten audit and assurance breaches for 2016](#)

## Regulator Inspections

We actively communicate with members the findings of ASIC inspections of Registered Company Auditors, Australian Taxation Office's reviews of registered SMSF auditors and the International Forum of Independent Regulators (IFIAR) survey of audit regulators. We record interviews with relevant regulators and publishing podcasts and a range of reports and other materials to detail and explain those findings. For the FRC's information, our member resources include:

- Podcast: [SMSF auditor compliance program findings for 2016-2017](#)
- Article: [Six warning signs the tax office uses when monitoring SMSF auditors](#)
- Article: [Six \(more\) threats to auditor independence](#)
- Podcast: [ASIC 2015-16 audit inspections](#)
- Podcast: [ASIC 2014-15 audit inspections](#)
- Article on IFIAR survey: [Why is it proving so hard to lift audit quality?](#)

In order to improve the quality and consistency of CPA Australia's quality reviews with regulators' inspections and for our Quality Review team to gain a better understanding of the reviews conducted by the regulators, we have initiated workshops with the regulators. These workshops involve our quality review team comparing approaches, findings and members' concerns with the regulator's inspection team. A workshop was conducted with the ATO in 2017 on SMSF auditors and is planned to continue annually. Planning is underway for a workshop with ASIC in early 2018 on RCAs.

## 2. Resources & Training

Audit quality is supported through resources to assist with the conduct of the audit including manuals which are regularly updated, live chats, webinars and podcasts, such as:

- Manual: Small Entity Audit Manual (SEAM)
- Guide: [Independence guide](#)
- Webinar: [Responding to Non-Compliance with Laws and Regulations](#)

Remaining up-to-date with the current accounting standards is also vital for auditors in conducting their work effectively. Competence is a key contributor to audit quality. We provide tools through our website, such as podcasts on the new accounting standards:

- IFRS 9 Financial Instruments
- IFRS 15 Revenue from Contracts with Customers
- IFRS 16 Leases
- IFRS 17 Insurance Contracts



We circulate updates on the latest developments in accounting and auditing standards through our weekly newsletter *CPA Update* and reflect those changes by updating website pages with relevant content. We also circulate the *Latest Ethics, Auditing and Reporting update* (LEARN) quarterly, which provides a snapshot of changes to reporting, auditing and ethical standards applicable now or available for early adoption.

We offer on-line training for accounting and auditing topics and include relevant sessions at CPA Congress, Not-for-Profit Forum and Public Practice Forum.

### **3. Research**

In the interests of the profession, CPA Australia funds research on topics which can contribute to audit quality and publish findings to inform stakeholders. For example:

- [Auditor professional scepticism: Impact of trust and distrust](#)
- [Auditor's reports in Australia 2005-2015: An updated analysis](#)

We share these findings also through articles and commentary in the media. Future research being funded in 2018 includes data analytics, how it can be used in the audit and whether the existing standards accommodate these new and evolving audit techniques.

### **4. Audit Quality Initiatives**

We are commencing work on two audit quality initiatives in conjunction with the Australian Public Policy Committee (largest six international networks). These projects are:

1. Accountability mechanisms for audit quality
2. Root cause analysis

The first initiative is led by CPA Australia, the second by CAANZ. CPA Australia's initiative will explore the drivers of audit quality and the measures of audit quality at the individual practitioner and staff level. The mechanisms being used in practice by the largest six firms currently will be explored through interviews, examining documentation of systems and processes in place and a workshop to draw out best practices. The output is intended to be a scalable model of accountability which could provide a best practice menu of techniques by which to drive and measure audit quality. This model or menu will then be shared with all practitioners to support improved techniques in all firms to boost audit quality.

The root cause analysis project will similarly draw on the existing practices of the largest six firms, then workshop and document the best practice approaches to identifying root causes of failures in audit quality. Again, these practices can be shared widely.

The objective of both projects is to improve audit quality on a practical level which is actionable by firms of all sizes.

### **Collaboration:**

#### **1. Regulators & Standard-setters**

CPA Australia representatives meet regularly with regulators including ASIC, ATO, ACNC and APRA to hear any issues of concern relating to reporting, auditing or ethics, raise matters which may require actions by the regulator or by us through raising awareness with members or advocating for legislative or regulatory change.

We meet with ASIC every quarter, as well as attending other stakeholder engagement sessions including Audit Committee Forums, Auditing and Accounting Standing committee and quarterly accounting liaison meetings.

We participate in regular stakeholder engagement sessions held by ATO, ACNC and APRA and actively contribute to discussion of matters impacting the conduct of audits in the relevant sector. We make submissions on amendments to auditor report templates, regulatory requirements and other material disseminated by the regulators with respect to reporting and audit.

CPA Australia attends AASB, AUASB and APESB meetings and contributes to development of standards through participation in project advisory groups, submissions to consultation papers and exposure drafts in response to IASB, IAASB and IESBA consultations.

We meet with the AUASB formally every two months to collaborate on initiatives such as communication with stakeholders, co-hosting roundtables to obtain stakeholder feedback or information sessions to inform of changes and to identify improvements the standards or guidance which support audit quality.

We hosted AASB roundtable consultations on the Financial Reporting framework for Charities in Adelaide, Sydney and Brisbane and AUASB roundtable strategy consultations in Adelaide, Perth and Sydney in October 2018. We also hosted panel discussions on auditor reporting implementation in Perth and Brisbane earlier in 2017 and on proposed auditing standard ISA 540 on accounting estimates in Sydney in June.

## **2. Practitioners and other stakeholders**

We attend regular discussion groups with stakeholders on reporting and auditing matters in Sydney (Sydney Research Group) and Melbourne (Emerging Reporting and Auditing Issues discussion group and Large National Networks discussion group). These groups are an opportunity to share concerns, discuss interpretation of standards and hear views which help to inform submissions on consultation papers and exposure drafts and to understand matters which may need to be addressed to support audit quality.

CPA Australia's External Reporting Centre of Excellence provides a forum for members to actively inform and support accounting and auditing policy. The committee meets quarterly and members are regularly consulted to inform specific submissions.

## **3. Monitoring Group audit reforms – bringing the profession together**

CPA Australia convened roundtable meetings in Sydney and Melbourne in December 2017 to bring the profession together to discuss the Monitoring Group's proposals for changes to international auditing standard-setting. These roundtables brought together key stakeholders, including IFAC, FRC, ASIC, AUASB, APESB and AICD, as well the Australian member of IESBA and former member of IAASB. The meetings facilitated the profession as a whole to draw out issues arising from the proposals which are ultimately intended to improve audit quality.

## Summary

CPA Australia has a long-standing commitment to promoting audit quality, as evidenced by the range and diversity of initiatives, actions and collaborations which occur throughout our organisation and across the profession.

From education and working directly with practitioners through to research and informing international policy and standard setting, our focus is on continuous improvement of audit quality and the consistency of audit execution.

At the same time, the drivers and impediments to audit quality are complex and multifaceted, as is widely acknowledged, so we would be pleased to continue our engagement with the FRC to explore further initiatives.

Again, I was pleased to meet with you earlier this month to directly discuss these and other matters and we look forward continuing our strong working relationship.

Yours sincerely

s 47F

A large grey rectangular box redacting the signature and name of Adam Awty.

Adam Awty CPA  
Interim Chief Executive Officer



22 December 2017

The Chair  
Mr Bill Edge  
c/- The Treasury  
Langton Crescent  
Canberra ACT 2600  
[frcsecretariat@treasury.gov.au](mailto:frcsecretariat@treasury.gov.au)

Dear Bill

We refer to your letter dated 21 November 2017 relating to audit quality.

On behalf of the Institute of Public Accountants (IPA) I would like to assure you and the Financial Reporting Council that the IPA is committed to improving audit quality across our membership and the profession more broadly.

We refer to the ASIC *Audit inspection program report for 2015-16* (Report 534) and note its findings; in particular, as noted in your letter, that 25 per cent of the total 390 key audit areas that were reviewed across 93 audit files did not obtain reasonable assurance that the financial report as a whole was free of material misstatement.

We note further the announcement by the former ASIC Chairman, Greg Medcraft, that this result was “appalling”, as reported in the media; and the consequent concern raised by Minister O’Dwyer.

We also have regard to ASIC Information Sheet 222 *Improving and maintaining audit quality*; Information Sheet 196 *Audit quality: The role of directors and audit committees*; RG 260 *Communicating findings from audit files to directors, audit committees or senior managers*; RG 34 *Auditor’ obligations: Reporting to ASIC*; and numerous other guidance from ASIC, AASB and others.

We also refer to the IPA’s report to the FRC on Registered Company Auditors in August 2017 which indicated that there is no cause for concern with respect to these auditors; and which outlined the IPA’s current quality assurance program to which auditors are subjected every three years. However, the IPA has considered the comments of the FRC around improvements; and has sourced reviewers with appropriate expertise to undertake face to face audits, in addition to the digital process.

Further, we refer to the ‘Areas for improvement’ outlined in Report 534 (p 6) and we are able to assure the FRC that the IPA will focus on improving audit quality through changes to our current programs on continuing professional development; technical information provided to members; tools and resources; helping firms to develop action plans; media and communications to raise awareness of the importance of audit quality; and activities focusing on cultural change.

In addition, as previously mentioned, the IPA has discussed a thought leadership initiative to improve audit quality with the IPA Deakin University SME Research Centre. We understand that representatives from Deakin University have held discussions with the FRC to scope a possible topic. We note that Report 534 (p 15) provides a useful outline of areas that require attention in order to improve and maintain audit quality and which could be the subject of further research and



analysis. For instance, 'action plans to improve audit quality' is an obvious activity, however, we question whether there is credible research to determine whether these action plans are being implemented and actually resulting in sustainable improvements.

The IPA contends that since the coverage of ASIC's inspections is limited to the point where extrapolations cannot be made, a supplementary process may be beneficial to broaden the coverage to more audit firms and especially to smaller firms. For instance, an online survey may be useful or even a type of online quality assurance program where firms are required to submit working papers, file documents and so on. This could be as narrow or as wide-reaching as needed, based on risk profiles, industry sectors, size or other criteria.

We also note that Report 534 (p6) states that 'Our inspections focus on higher risk audit areas and so caution is needed in generalising the results across the entire market. We generally select some of the more complex, demanding and challenging audits, and some more significant or higher risk areas of the financial reports'. 'Hence, purely random reviews could result in a different level of findings than indicated in paragraph 3'. Therefore, the IPA contends that the findings are unlikely to be representative of audit quality more generally. Reports from the professional accounting bodies about their respective members may be useful when seeking to ascertain the extent of the issues. We note that the IPA report on Registered Company Auditors mentioned above did not indicate any cause for concern.

However, it may well be that the way we identify, measure, report and evaluate audit quality needs to be revised. Report 534 (p 9) appears to indicate that it's not possible to draw any statistically rigorous conclusions, nor to establish a trendline, from the findings. Even though figures are presented for 2015 and 2016, the note states that the percentages are 'not directly comparable between periods'.

The IPA's main focus is on small business and SMEs, since three-quarters of our members work or advise in these sectors. ASIC inspected only nine small firms and reviewed only one file at each. In order to determine more accurately the state of audit quality with respect to smaller firms, it might require a much larger sample size. Since this may not be possible given time and resources, an online survey or quality assurance type process, as outlined above, may be beneficial. The professional accounting bodies and their respective research facilities are already established and able to undertake this work in our co-regulatory system.

However, since smaller reporting entities do not present a systemic risk, we believe it would be preferable to reduce the reporting requirements on these entities, including incorporated associations. One option is to reduce the audit threshold, that is, the point at which an entity requires an audit to be performed by an RCA, thereby increasing the capacity for non-RCAs to undertake reviews. IPA members play an increasingly important role in the Not-for-Profit and charities sectors and we believe this should also be taken into account when reviewing the entire audit and assurance review framework. All of these measures, especially in aggregate, would have the benefit of reducing red tape and compliance for these entities while also reducing ASIC's workload; and without compromising audit quality given the other proposals we have outlined.



We believe another area of focus should be on new technologies and their influence on audit effectiveness and assurance. As noted in Report 534 (p 25), these technologies may include data analytics, robotics and cognitive learning. As with the legal profession which has been disrupted by smart contracts, it may well be that errors and other noteworthy items in an audit context are identified and dealt with as they happen.

Overall, the IPA shares the concerns raised by ASIC in Report 534, though we believe that further research and analysis is required to ascertain a broader view of what is happening. In the meantime, we will undertake further activities aimed at improving audit quality.

Please feel free to contact me on either mobile 0409 940 567 or at [andrew.conway@publicaccountants.org.au](mailto:andrew.conway@publicaccountants.org.au) to discuss the above or if you have any queries.

Yours sincerely

s 47F

Prof Andrew Conway FIPA FFA  
Chief Executive Officer