



25 October 2019

The Group of 100 Incorporated

Committee Secretary
Parliamentary Joint Committee on Corporations
and Financial Services
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Submitted online

Dear Sir/Madam,

The Group of 100 (G100) is the nation's peak body for CFOs and leading finance professionals in many of the country's largest businesses. Our purpose is to create better businesses for tomorrow, and part of how we deliver this is to pro-actively contribute on a business-to-government level on matters affecting business regulation, financial reporting, corporate governance, capital markets, taxation and financial management.

Our corporate members are at the forefront of interaction between business and the auditing profession. They are responsible to the Board for the preparation of the financial statements that are audited, the maintenance of the internal controls over the systems upon which those statements are based, the release to the market (where listed) of those results and the explanation of the detail to investors and the day-to-day relationship between the business and the auditor.

It is therefore of fundamental importance to the G100 membership and the wider Australian business community as well as to Australian (and overseas) investors that these financial statements, their audit and the regulatory regime that supports them continue to be seen as reliable and of a high quality and that the auditors and regulators are free from interference and independent.

We further note the interaction of the Continuous Disclosure regime applicable to Australian listed entities, and the Board and Management's responsibilities for ensuring that the market is informed of material events pertaining to the Company's operations. We continue to be supportive of this regime as providing valuable safeguards for investors.

It is important to note that auditors are not responsible for opining on continuous disclosure matters – this remains the responsibility of the Board which reinforces the very salient point that ultimately it is the Board who are responsible to the shareholders for the operation of a Company, for its internal controls and for its financial statements.

We have taken the opportunity to respond directly to some of the matters referred to the Joint Committee below, and welcome the opportunity to discuss these and other relevant matters with the Joint Committee. We should note that our membership is drawn primarily from larger listed corporates, and it is their experiences and observation which are reflected below.

The G100 notes that this submission is a public submission.

Submission

Relationship between auditing and consulting services and potential conflicts of interests

Audit firms are able to most effectively do their job when their staff and partners can combine wide experience in relevant sectors with professional scepticism.

It is equally important for the continuing strength of the profession, and the value of the audit, that audit firms continue to draw from a talented and engaged pool of professionals and would-be professionals.

Accountancy firms can offer an interesting variety of work across corporate clients, with experience of consulting work benefitting audit work, whether with different clients or the same client.

What is regarded as fundamentally important in this area by Boards and Audit Committees is that the external auditors do not audit their own work. For instance, professional advice on valuations of assets where such valuations are used in the financial statements should be done by a firm independent of the auditor.

Other consultancy services such as work done by an auditor in their capacity as auditor as part of due diligence of a Prospectus or Cleansing Notice could be categorised as 'audit related.' It is worth considering whether guidance should be provided (possibly by the Accounting Professional and Ethical Standards Board (APESB)) as to what types of work should be considered 'audit related' services. These can include items such as regulatory filings required to be done by the auditor, and work done by the auditor for scheme documentation.

In other cases, the auditor's knowledge of a corporate's business, systems and processes enables them to provide valuable advice in these areas (often with less time and thus expense due to such experience) without impacting on the financial statements, or requiring auditors to audit their own firm's work.

In all cases, it should be the responsibility of the Audit Committee or Board to satisfy itself that engagements with and work performed by its audit firm that is not part of the statutory audit does not lead a situation where the auditor is auditing their own firm's work (as laid down in the ASX Corporate Governance Guidelines).

Simultaneously the audit firm will also ensure that any such work meets its own independence standards.

The reputation and integrity of professional service firms, and individual staff and Partners, is fundamental to their ongoing success. Similarly, Directors at Australia's largest corporations are, we believe, very conscious of their own reputations and their responsibilities in this area.

It is our contention that these reputations and future incomes (across all aspects of a firm's business), which would be severely damaged or destroyed by proven conflicts-of-interest leading to malign outcomes or to work being deliberately performed not in accordance with regulatory standards, would not be put at risk because of any conflict of interest between auditing and consulting (or other) services.

Other potential conflicts of interest

The mandatory 5-year Partner rotation has been of benefit in ensuring that on a personal level an audit partner remains detached and is also able to bring experiences at one client to others.

For the larger corporates which represent our membership, the size of the audits and the teams, and the

career paths offered by audit firms, means that there is a regular change-over within audit teams, presenting the audit partner (and the corporate) with a continued 'fresh pair of eyes.'

This has reduced the possibility that external auditors become too embedded within a client and are unable to maintain professional scepticism and independence.

The Committee should note that the Australian Accounting Professional and Ethical Standards board ("APESB") has revised and reissued its Code of Ethics for Professional Accountants (APES 110) which is effective from 1 January 2020. This has specific prohibitions and requirements on auditor independence, conflicts of interest and non-assurance standards. According to the APESB "the professional standards framework applicable to accountants in Australia is significantly different from what exists in the UK. Globally only the US has a comparable professional standards framework for the accounting profession."

The Committee should further note that the International Ethics Standards Board for Accountants ("IESBA") is also undertaking a review of its Code on Non-Assurance Services with a view to issuing an Exposure Draft by the end of the current calendar year with consultation next year.

It is recommended that the Committee should assess the impact of the changes to both of these codes before determining what, if any, further requirements for Australian circumstances are necessary.

Level and effectiveness of competition in audit and related consulting services

The G100 does not believe that, with the current market structure, and the structure of the professional services firms themselves providing multi-disciplinary work including audit, there is a shortage of competition in audit and related services. We would note that although fees paid to the audit firm are disclosed by listed entities, there is no similar obligation for these entities to disclose the fees paid to firms that are not their auditors. Consequently, there is no public information on an entity-by-entity basis disclosing how much in consulting or other fees are paid to accounting firms that are NOT the company's auditor. This is not an argument that such fees should be disclosed or detailed, merely that the picture currently disclosed is not the full one.

However, should one of the large 'Big 4' remove themselves from the provision of audit services, this would cause concern. We note with concern recent reports from the UK that 'risky' or 'unprofitable' clients are facing difficulties in securing suitable auditors (*AFR* 7th August 2019) but have yet to see this happening in Australia.

Regulation to enforce a full structural and operational split of auditing work away from other professional services would, we believe, be extremely detrimental to the provision of auditing services to corporate Australia.

This would remove the ability of an audit firm to rely on other expertise during the course of an audit (i.e. tax experts on review of taxation balances and expense, HR and remuneration consultants for the audit of remuneration plans and details in the Remuneration Report, valuation experts for asset values etc.), increasing expense and complexity as other forms have to be brought in to provide such advice, which in itself would still need to be reviewed by the external auditor; reduce the career paths of potential auditors and ultimately potentially reduce competition in the sector for large, complex audits.

The role of the auditor is itself changing, with Boards now looking for reviews of culture, performance metrics and other matters integral to a Company's reporting but not directly included in the financial statements. Such reviews do not, we believe, compromise an auditor's independence but do reflect the additional value that a well-resourced and multi-disciplinary firm can bring to a company and its stakeholders.

The G100 believes that such enforced separation into 'stand alone' audit firms would actually reduce the effectiveness and quality of audits whilst increasing costs in order to address potential 'conflict of interest' situations that are producing poor audits, a situation that we do not believe exists.

Audit quality

The G100 believes anecdotally that the audit quality experienced by Australian corporates is fundamentally of a very high standard, whilst noting the FRC's, ASIC's and the auditing profession's and audit firms' stated desire (as shown by the FRC's Audit Quality Action Plan) to continue to build on these high standards in the spirit of continual improvement. We strongly support this objective of continued improvement of audit quality.

We would note that the FRC survey of professional investors in 2019 found that 93% of those that participated rated their perception of audit quality as 'average' (33%) or 'above average' (66%).

These findings also echo the FRC's survey of Audit Committee Chairs in 2018 with 92% rating their external auditor as 'above average' (54%) or 'excellent' (38%) with only 1 % rating them as below average.

It is interesting to note that in this latter survey of the perceptions of audit quality, for instance to the question "How satisfied were you with the way in which your external audit demonstrated that they had adopted an appropriate mind-set and culture, and acted with appropriate professional scepticism?" the responses were higher for the ASX 200 (ave. 6.1 out of 7) than in the smaller companies (ave. 5.6 out of 7).

This may highlight that it is easier to demonstrate such attributes within a larger audit than a smaller one. It should not be construed as indicating that there was a perception that such a mind-set did not exist or that the auditors did not act with appropriate professional scepticism, only the degree to which it had been demonstrated.

The G100 is currently working with the FRC on a survey of audit quality amongst our members and the wider CFO community.

Matters arising from Australian and international reviews of auditing

ASIC does an annual review of audit work. We believe that ASIC expects the highest possible standards, which the G100 supports. We further support ASIC's comments that sustainable improvements require a focus on culture and talent.

We should note that due to the limited amount of information regarding the findings, it is difficult to assess to what extent negative findings were from larger, systemically more 'risky' audits or smaller companies, or where lack of 'a basis to support their evidence' indicates a lack of proper documentation and evidence - as ASIC notes, "ASIC's findings do not necessarily mean that the financial reports audited were materially misstated."

We note the Brydon Review underway in the UK, and particularly await its findings on the future of audit and what its role should be.

We note that Australian Auditing Standards are based on international standards. The G100 supports this where it leads to high-quality, best-practice in audit.

However, we would also note that Australia as a market does have its own conditions and settings, particularly when (as previously noted) the interaction of Continuous Disclosure is taken into consideration. Findings and decisions that are made overseas should not necessarily be actioned in Australia without due consideration as to their suitability, additional burden of regulation and cost/benefit analysis.

Changes in the role of Audit

For Directors, corporate executives and auditors the role of a 'pure' statutory financial statements audit should be clear – it is to provide assurance that, based on their audit work, the published financial statements are free from material error.

There are indications, however, that in the mind of the general public an audit should also cover two of the most pertinent topics, fraud and going concern.

To take the latter first, going concern is fundamentally an issue of asking whether the auditors agree with the Director's judgement that the company can continue in operation for the immediately foreseeable future.

It is very important that any changes in this area be very carefully considered. Directors should not abrogate their responsibilities either in the financial statements or in continuous disclosure for informing the market and shareholders about any issues arising out of going concern. Equally, however, auditors need to be able to satisfy themselves that the going concern basis is appropriate. There may be scope for further explanation to stakeholders as to what work has been done to provide this assurance.

Equally, Directors should not be held responsible for changes in business and operating environments that were either unknown, unknowable or could not have been adequately planned for.

Role and effectiveness of audit in detecting fraud

Contrary to some popular opinion, it is not the role of the external auditor to look for fraud unless such frauds directly cause a material misstatement of a Company's financial statements.

Currently, and appropriately, it is the Board's responsibility to ensure that management have set up a sound system of internal controls that are designed, amongst other things, to detect and prevent fraud. This is usually acknowledged in the Corporate Governance Statement for ASX listed companies.

One of these controls for larger corporates involves an internal audit function. It will often be one of the roles of internal audit to design tests to detect possible fraud and review and report on controls designed to prevent such fraud.

It may be that more explanation needs to be made publicly about the two different roles and expectations. Boards should also seek to safeguard the independence of the internal audit function, with reporting lines directly through to the Audit Committee. In many cases, KPIs and remuneration of internal auditors are also the responsibility of the Audit Committee. The 4th Edition of the ASX Corporate Governance Guidelines states that the Audit Committee has responsibility for the appointment or removal of the head of internal audit; the scope and adequacy of the internal audit work plan and the independence, objectivity and performance of the internal audit function.

For smaller companies without internal auditors, the external auditor may play a role in reviewing and reporting on controls in this area but care would need to be taken that such work did not impinge upon its independence, and that this did not result in an increase in the cost burden on corporates without tangible benefits.

It should also be noted for the sake of completeness that audit, whether internal or external, cannot be expected to uncover all frauds or misdemeanours, particularly where collusion is involved. Furthermore, the responsibilities of and work done by internal and external auditors does not abrogate Board and Management's responsibilities in these areas, a fact which the G100 acknowledges.

Audit and auditor regulation

The G100 believes that Australia has an extremely high level of regulation in this area, as evidenced by the FRC and by ASIC (acknowledging the role that one of our Board Members has as a member of the FRC).

The very high standards that ASIC sets for itself and the auditing profession can lead the results of its findings, when viewed in isolation, to give a misleading impression of the state of audit quality in the country. Investors, and corporates, expect auditors to be held to high standards and to be able to demonstrate continued improvement, and we believe, to a large extent, that this is currently the case.

The G100 believes that the current system of audit, auditor and regulation of audit is working appropriately as far as its constituent corporate member base is concerned.

The G100 wishes to note that as part of its strategic objectives its membership includes the 'Big 4' professional accounting services firms – Deloitte, EY, KPMG and PwC. A representative of each of those firms sits as a Director on the Board of the G100.

In order to maintain objectivity and independence, this submission was prepared, reviewed and approved by a sub-committee of the Board consisting of those Directors who are NOT members of the above firms.

We welcome the opportunity to make this submission representing the interests of a significant section of the market for audit and note that we are happy to discuss the contents of this submission at your discretion.

Yours faithfully

Andrew Porter
Chair

Stephen Woodhill
Executive Director and CEO

