APESB

Accounting Professional & Ethical Standards Board

AGENDA PAPER

Item Number:	10
Date of Meeting:	17 November 2023
Subject:	Update on Parliamentary Inquiries relating to the accounting profession

☐ **Action required** ☒ **For discussion** ☒ **For noting** ☐ **For information**

Purpose

To update the Board on the Parliament Inquiries relating to the accounting profession.

Introduction

In recent years, there has been an increased number of ethical failures in the accounting profession, from cheating on ethics exams to frauds, breaches of confidentiality and conflicts of interest. In Australia, these ethical failures have led to the initiation of several parliamentary inquiries impacting the accounting profession.

An update was provided at the August 2023 Board meeting, including a high-level summary of the following recent and current Parliament Inquiries related to the accounting profession (Agenda Item 11):

- Senate Finance and Public Administration References (FPAR) Committee Inquiry into the management and assurance of integrity by consulting services;
- New South Wales Government's Upper House Public Accountability and Works Committee (NSWPAC) has established an inquiry into the use and management of consulting services by the NSW Government agencies; and
- Parliamentary Joint Committee on Corporations and Financial Services (PJC) Inquiry into Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry

APESB have engaged with these inquiries by providing submissions and appearing at the PJC Inquiry into the Regulation of Auditing in Australia (2019) and NSW public hearing (2023). APESB will also appear at the PJC public hearing for its inquiry into Ethics and Professional Accountability in early 2024.

FPAR Committee Inquiry into management and assurance of integrity by consulting services

On 9 March 2023, the Senate referred an inquiry into management and assurance of integrity by consulting services to the Senate Finance and Public Administration References (FPAR) Committee. The Committee was asked to report by 26 September 2023, but this has been extended to 28 March 2024.

The Terms of Reference for the FPAR Inquiry were to consider how consulting engagements are managed by the Government or other regulatory bodies, the oversight of consultants and how conflicts of interests and other integrity breaches are managed. The FPAR Inquiry has received 57 submissions as at the date this report was written.

APESB made a submission to the FPAR Committee on 21 April 2023, which provided information about the role of APESB and the Code. The submission highlighted the relevant provisions in APESB pronouncements relating to conflicts of interest and the need for a quality management system. The submission noted the APESB pronouncements only apply to professional accountants and their firms, which provide consulting services. There may be other consultants who are not subject to a code of ethics, depending on their discipline.

The Committee held eight public hearings from May to 9 November 2023. The FPAR Committee also issued a report in June 2023 specifically on the PwC matter (PwC: A calculated breach of trust).

NSW Government- Inquiry into NSW Government's use and management of consulting services

On 6 June 2023, the New South Wales Government's Upper House Public Accountability and Works Committee (NSWPAC) established an inquiry into the use and management of consulting services by the NSW Government agencies.

The Terms of Reference for this Inquiry are to inquire into how government departments utilise consulting services, the related policies and oversight for the procurement of these services and the measures in place to prevent or manage conflicts of interest, breaches of contracts and other ethical behaviour. The Committee have received 28 submissions to date.

In July 2023, APESB made a submission to this Committee. The submission noted that the existing professional standards, such as the Code, Quality Management Framework for Non-Assurance Services (APES 320) and other APESB standards, already address conflicts of interest. The submission encouraged the NSWPAC to consider existing frameworks in place in the development of any proposed recommendations from the Inquiry.

APESB also strongly supported regulators and monitoring bodies taking appropriate enforcement and disciplinary action for non-compliance with legislation, regulatory and professional standards.

The NSWPAC held nine public hearings between 15 June 2023 and 6 September 2023. The APESB Chairman, Ms Nancy Milne OAM, and CEO, Mr Channa Wijesinghe, appeared at a public hearing held in Sydney on 9 August 2023. In the Opening Statement, APESB presented a preliminary view of potential measures to improve the current co-regulatory framework.

PJC Inquiry into Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry

On 22 June 2023, the PJC resolved to commence an inquiry into Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry. This inquiry was due to recent allegations of misconduct in the Australian operations of the major accounting, auditing and consultancy firms. Refer to the Terms of Reference for this PJC Inquiry.

The Committee called for written submissions by 31 August 2023. However, the Committee acknowledged it is able to consider submissions received after that date. The Committee intends to report to the Parliament by mid-2024.

On 2 August 2023, APESB held a Board Workshop with some key stakeholders to get their views on the current regulatory framework and whether it can be enhanced. The feedback received during the Board Workshop assisted APESB in preparing its submission.

APESB also met the Big Six firms individually between 18 August 2023 and 1 September 2023 to discuss the key themes in APESB's submission to the PJC Inquiry.

On 31 August 2023, APESB made a submission to the Committee. The submission noted the APESB's views that the current regulatory framework is not working and provided some recommendations for the Committee's consideration to improve the ethics and professional accountability of large professional services firms (accounting and other consultants).

The Committee held public hearings on 6 October and 3 November 2023. The transcripts of the hearings are available on the Government's website. APESB was initially scheduled to appear at a public hearing of this inquiry on 2 November 2023, but the PJC has requested that the appearance be rescheduled to early 2024.

At the date of writing this report, the PJC has published 72 submissions on the Parliament of Australia website received in response to their Terms of Reference. Technical Staff have reviewed the submissions to determine the key themes that may have an impact on APESB's activities.

Key themes in submissions to the PJC

There is a wide range of views expressed in the submissions made to the PJC inquiry so far. Technical Staff noted some of the key themes or recommendations that are relevant for APESB are:

Enhance transparency of large professional service firms

Most of the submissions (including the Big Five[1] firms and the three professional accounting bodies) were supportive of enhancing transparency in large firms. Several academics, research organisations and regulators have raised concerns regarding the absence of transparency in large firms, highlighting the need to restore public trust and confidence in the operations of large firms.

The Big Four firms generally support the mandate for large accounting firms to prepare financial statements, including disclosure on remuneration and fees.

- Similar to APESB's recommendation, the Big Four firms have drawn attention to the UK Limited Liability Partnerships (LLPs) as a case study for the Government to consider for reporting requirements in Australia.

[1] At the day of writing this report, Grant Thornton has not made a submission to the PJC on the inquiry into Ethics and Professional Accountability.

- EY further considered implementing similar reporting requirements to those that large proprietary companies in Australia currently need to comply with. Such reporting obligations would require Large Registered Partnerships (those with partnerships with over 100 partners and/or $50m revenue) to submit annual reports that are compliant with Australian Accounting Standards and have their financial statements audited. It is believed that applying the large proprietary companies' reporting requirement would ensure that future modifications to this framework will immediately apply to Large Registered Partnerships.

Some academics also suggested requiring the Australian Securities and Investments Commission (ASIC) to publish comparative data, including audit and assurance fees, key audit matters, and naming companies whose audit files are under surveillance and reporting audit deficiencies to shareholders and the Board.

Focus on large firm culture and governance

Several academics stated the importance of culture and leadership in promoting ethical behaviour within the firms. They highlighted the ethical failures were due to the poor firm culture and leadership-related issues.

- One academic submission did mention that further strengthening the ringfencing of operations is unlikely to succeed when this culture is present in an organisation. This is because the competitive incentive systems at organisations may override the internal controls in place regardless of their importance.
- Some academics suggested looking into ethical frameworks on issues that impact firm culture and governance, such as the development of ethical and compliant practices in leaders and managers, as well as strengthening rules around disclosure of conflicts of interest and whistleblowing.

The International Ethics Standards Board for Accountants (IESBA) also acknowledged issues with firm culture and governance in light of the recurring cases of ethical behaviour globally. The IESBA is considering prioritising a project to address governance and culture in accountancy firms in its Strategy and Work Plan for 2024 - 2027.

PwC referred to the UK Audit Firm Governance Code for the Committee's consideration, which is consistent with one of APESB's recommendations. In preparing its submission, PwC considered the governance frameworks in other jurisdictions and found that the UK framework has the most relevance for the Australian market.

Establish an independent oversight body

There were a number of submissions from academics, large firms, and a professional body that supported an independent oversight body oversee the professional services firms. One academic further suggested establishing a new independent single regulator for accounting professionals with the power to set technical and ethical standards, evaluate and impose sanctions.

There was one anonymous submission that suggested the new audit regulator should be able to inquire about breaches of audit standards, including the standards promulgated by APESB, regardless of a professional body's action. The respondent also suggested considering the UK's work on establishing the Audit, Reporting and Governance Authority (ARGA) if pursuing a future split of enforcement functions.

Some accounting firms (from the Big Four and mid-tier firms) supported the establishment of a single regulator to oversee the accounting professionals and firms. Their recommendations included the independent oversight body being responsible for monitoring the conduct of registered professionals, taking enforcement actions, handling misconduct reporting and overseeing large partnerships.

The Financial Reporting Council (FRC) observed that only registered company auditors are subject to oversight by an independent regulator (ASIC). However, there are other auditors, accountants and consultants who are not subject to any oversight by an independent government body.

In IPA's submission, it referred to a proposed model in the UK, where it could involve the establishment of the FRC as the single regulatory clearinghouse for the accounting profession, with compulsory information gathering and information sharing powers and power to sanction non-compliance with information gathering. The FRC could then delegate complaint handling to each of the professional bodies, to be undertaken either in compliance with their individual by-laws or a joint approach or joint framework could be considered.

ASIC also mentioned in its submission that several international jurisdictions have increased regulation of auditing and accounting firms and included examples from the UK and USA:

- The UK Government established ARGA (replacing and expanding on the role of the current UK regulator, the Financial Reporting Council), followed by the update to the UK Corporate Governance Code.
- The US government enacted the "Sarbanes-Oxley Act" and established the Public Company Accounting Oversight Board (PCAOB) to empower it to conduct investigations and disciplinary proceedings concerning registered accounting firms for violation of the laws, including professional standards, and to take disciplinary actions for those violations.

The Australian Restructuring Insolvency and Turnaround Association (ARITA), on the other hand, had a different view of having one regulator or professional body overseeing firms of multiple specialties. In ARITA's view, without the knowledgeable scrutiny of specialist professional bodies, it would be possible for highly technical and nuanced non-compliance issues to go unquestioned, as it would not be possible for a single regulator to be across all technical aspects of the services provided by large firms.

Separation of audit and non-audit parts of the firms

There were mixed views on whether to separate the audit and non-audit divisions of the audit firms. The majority of supporters were academics, providing the view that separation would remove inherent conflicts of interest and the resultant impact on audit quality. They support the split of the audit and consultancy divisions when firms provide both services to the same clients and prohibit the sale of non-audit services to audit clients.

Two of the Big Four firms have the following views on the split, noting in their submissions:

- EY provided facts that audit is not a "loss leader" for non-audit services to attract other consulting services to audit clients. Auditors are prohibited from providing a large range of services to audit clients, and it is prohibited for audit partners to sell non-audit services. As such, the audit partners have no incentive to do so, as the delivery of quality audits is the main determinant in their annual performance evaluation.
- KPMG believe that separation would bring significant challenges in audit service and quality. The separation will lead to outsourcing a separate range of other experts to deliver audit quality. If these experts were to be outsourced from outside, maintaining adherence to strict audit independence requirements as required under the *Corporations Act 2001* and APES 110 would create significant challenges and pose a risk to audit integrity.

One professional body, the IPA, also raised concerns that requiring the separation would have a major impact on the profession. If more restrictive controls are considered appropriate, the most obvious solution would be to restrict firms from providing audit services to non-audit clients (and vice versa).

Impact of the ASIC Restructure

A number of submissions expressed concerns over ASIC and the impacts of its recent restructuring on its priorities and resource allocation. In particular, the FRC stated in its submission that ASIC has decreased the number of audit engagements they have inspected in recent years.

There was one anonymous submission that mentioned the ASIC restructuring, noting the dismissal of its chief accountant and the cut back on its audit surveillance program.

A mid-tier firm, BDO, noted the recent change to ASIC's approach to audit inspections reflected a shift in its priorities where funds will be directed from supervision to enforcement. Nevertheless, BDO would support a review of this decision to ensure adequate funding is provided for supervision.

The Companies Auditors Disciplinary Board (CADB) also suggested ways to address the relatively infrequent utilisation of CADB's jurisdiction in the past by ASIC and APRA. It was raised that over a sustained period, relatively few registered auditors have faced disciplinary proceedings, with the result that there is limited transparency about their compliance with professional standards.

Furthermore, the three professional accounting bodies provided comments on ASIC, stating their suggestions in their respective submissions:

- IPA stated that greater transparency and accountability are needed from ASIC to properly assess the allocation of funds against its functions, especially supervision and enforcement, which make up the bulk of the cost.
- CPA Australia noted that the recent changes at ASIC in relation to audit supervision and financial reporting should ensure that it is able to maintain proper monitoring and enforcement oversight through its surveillance activities and local and international stakeholder engagement and that it has sufficient capacity to implement and enforce expanding corporate reporting and assurance requirements.
- CA ANZ restated its support for ASIC's auditor surveillance and audit firm oversight programs. CA ANZ also suggested that the review of the regulatory framework should also consider the scope of ASIC's audit firm oversight, the industry funding model, and regulatory capability, performance, and accountability.

Way Forward

Technical Staff will continue to monitor the government inquiries' progress and outcomes and update the Board on key developments.

Recommendations

That the Board note the update on the Government Inquiries.

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Date: 10 November 2023