

Financial Reporting Council

Annual Report 2011-12

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Secretary
Financial Reporting Council
c/ The Treasury
Langton Crescent Parkes ACT 2600
Email: frcsecretary@treasury.gov.au

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Australian Government

Financial Reporting Council

Chairman:
Ms Lynn Wood
c/- The Treasury
Langton Crescent
Canberra ACT 2600

Email:
chairman@frc.gov.au

Secretariat:
c/- The Treasury
Langton Crescent
Canberra ACT 2600

Telephone:
02 6263 3144

Facsimile:
02 6263 2770

Email:
frcsecretary@treasury.gov.au

18 October 2012

The Hon Wayne Swan MP
Deputy Prime Minister and Treasurer
Parliament House
CANBERRA ACT 2600

Dear Deputy Prime Minister

I have pleasure in presenting the annual report of the Financial Reporting Council (FRC) for the year ended 30 June 2012.

The report has been prepared in accordance with sections 235B and 235BA of the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

Subsection 235B(1) of the ASIC Act requires the FRC to prepare a report on its operations during the year, and on the achievement of the objects of Part 12 of the ASIC Act relating to accounting and auditing standards. Subsection 235BA(1) of the Act requires the FRC to prepare a report on its performance of its auditor independence functions, the findings and conclusions reached by the FRC in performing those functions, and the actions (if any) taken by the FRC in respect of those findings and conclusions.

The FRC auditor independence function and associated reporting requirements were repealed under the *Corporations Legislation Amendment (Audit Enhancement) Act 2012*, with commencement on 27 June 2012, which will have effect from the 2012-13 reporting period.

Subsections 235B(4) and 235BA(3) of the ASIC Act require the report to be tabled in each House of the Parliament as soon as practicable.

Yours sincerely

A handwritten signature in cursive script that reads 'Lynn Wood'.

Lynn Wood
Chairman

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INTRODUCTION

The Financial Reporting Council (FRC) is the peak body responsible for overseeing the effectiveness of the financial reporting framework in Australia. Its key functions include the oversight of the accounting and auditing standards setting processes for the public and private sectors, monitoring the effectiveness of the auditor independence regime, and advising the Minister on these matters. However the FRC auditor independence function and associated reporting requirements were repealed under the *Corporations Legislation Amendment (Audit Enhancement) Act 2012*, with commencement on 27 June 2012, which will take effect from the 2012-13 reporting period.

The FRC has a wide range of stakeholders, including a broad spectrum of preparers and users of financial statements, the Australian, State and Territory governments, and other government bodies such as standards setters and regulators. Key stakeholder bodies are represented on the FRC as Members (Appendix A). In addition, the Australian and New Zealand governments have established cross-appointment arrangements to promote closer economic relationships between the two countries. The FRC accordingly has a New Zealand representative as one of its Members.

As part of its role of overseeing the standards setting processes, the FRC's responsibilities include appointing the members (other than the Chairmen) of the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB), and determining the broad strategic directions of the AASB and AUASB. The FRC's responsibilities also include giving advice or feedback to the AASB and AUASB on their priorities, business plans and procedures and to the Offices of the AASB and AUASB on their budgets and staffing arrangements.

The AASB deals with the setting of accounting standards for the public and private sectors of the Australian economy, while the AUASB focuses on the development and setting of auditing and assurance standards and guidance. Both Boards are agencies for the purposes of the *Financial Management and Accountability Act 1997* and will be providing separate annual reports to the Minister concerning their operations during 2011-12.

Under the auditor independence function, the FRC is responsible for monitoring the systems and processes used by Australian auditors to ensure their compliance with auditor independence requirements. The FRC also monitors the professional accounting bodies' planning and performance of quality assurance reviews of audit work undertaken by Australian auditors to the extent to which those reviews relate to auditor independence requirements. As noted above, in future years the FRC will not have this function.

FRC members approved the FRC Strategic Plan 2011-14 (Appendix B) in April 2011 to review the main functions of the FRC, conduct a SWOT (strengths, weaknesses, opportunities and threats) analysis of the financial reporting framework in Australia, define a range of strategic issues to be considered by the FRC, and develop an action plan for the FRC.

Based on the SWOT analysis and the list of strategic issues, the strategic plan defines a range of projects to be executed by the FRC over the three-year period from 2011-2014. Priority projects for which the FRC is taking a thought leadership role are being progressed by Task Forces of three or more members with a chairman who is an FRC Member. The Task Forces are supplemented in some cases by selected non-FRC members. A summary of the Task Forces and their members during the 2011-12 period is provided in Appendix C.

The main objective of each Task Force is to analyse the topic of interest with a view to producing a high-level identification of the key issues and possible solutions. Solutions that are straightforward to adopt will be or have been recommended to the FRC for implementation. If further, more detailed work appears to be needed, the matter will be reported back to the FRC, which will then decide how best to proceed. The Strategic Plan will be reviewed during 2012-13 in light of the Task Forces' recommendations.

In the performance of these functions, the FRC is assisted by a Secretariat which is located at the Treasury. The FRC meets at least once each quarter. Its funding is provided through an Australian Government appropriation.

CHAIRMAN'S REPORT



The movement toward greater adoption of the International Accounting Standards Board's (IASB) International Financial Reporting Standards (IFRS) has continued apace. Within the broad Asia-Oceania region, the trend is clear: with announcements regarding adoption by Indonesia, Malaysia, Singapore and Saudi Arabia in 2011-12. Hopefully the United States will make a positive decision on adopting IFRS within the coming year.

There has also been much attention given to various efforts to reform audit processes worldwide. The Australian Government enacted the *Corporations Legislation Amendment (Audit Enhancement) Act 2012* in June. This Act clarifies the respective roles of the FRC and the Australian Securities and Investments Commission (ASIC) in ensuring high quality auditing standards in Australia as they relate to auditor independence. In future years the FRC will have a strategic role in terms of advice to the Minister rather than a role in monitoring and reporting on auditor independence arrangements. This new role has been reflected in a review of how the FRC performs its functions, conducted in June 2012.

FRC Strategic Plan 2011-2014

The FRC Strategic Plan has now been in operation for a full year, and is starting to bear fruit.

The Managing Complexity Task Force has undertaken a comprehensive review of the complexities in financial reporting. Based on this work and substantial input from the FRC stakeholder organisations, the Task Force concluded that the way forward is to pursue a number of steps to manage complexity, recognising the sophistication of contemporary corporations and investment markets, and harnessing the innovative forces of information technology. The Task Force sought not to specify solutions to complexity, but rather to inform, influence and stimulate the debate on how best to manage it. It sought input from the broader financial reporting community on its suggested approaches on 29 May 2012 in its report *Managing Complexity in Financial Reporting*.

In order to influence the global debate on integrated reporting, the Integrated Reporting Task Force prepared an FRC submission to the International Integrated Reporting Committee (IIRC) with the aim of contributing to the development of an international consensus on the way forward. This submission advocated the

preservation of the existing material presented in the financial statements, and urged the IIRC to build a conceptual framework, as has been done for IFRS, to underpin any specific actions recommended on integrated reporting.

The Board Education Task Force conducted a survey of directors and financial reporting professionals, working with them to identify if there are any issues in terms on the financial literacy of directors and, if so, how to address them.

The Public Sector Task Force has continued to monitor international developments in relation to public sector reporting.

International and domestic developments regarding audit issues have meant that our Audit Quality Task Force has also been very active. It led the review of the FRC functions which resulted in this Task Force becoming a Committee of the FRC reflecting its ongoing role in providing advice to the FRC on the raft of audit reform activities occurring internationally as well as on domestic developments.

Oversight of standards setting

At the domestic level the FRC has sought to enhance engagement with both of our standards setters – the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB). The AASB and AUASB each prepared a strategic plan and sought feedback from the FRC. The FRC set up sub-committees to examine and provide comment on the plans. The FRC is very pleased with the finalised plans and believes they will contribute to ensuring that Australia continues to have an appropriate, robust and dynamic financial reporting framework.

At the international level the IASB has been committed to completion of its four convergence projects with the US Financial Accounting Standards Board. Australia welcomes the announcement by the IFRS Trustees to set up a regional office in Tokyo and the decision by Japan to allow voluntary adoption of IFRS with a decision on full IFRS adoption expected in the coming year. We also hope, as previously stated, for positive developments in the US that might lead them to make a decision.

Our links with New Zealand have continued to be strong and I attended meetings of the New Zealand External Reporting Board which were both useful and informative.

Within the broader Asia-Oceania region we continue to see strong moves toward greater harmonisation of accounting and auditing standards and note the increasingly important role taken by the Asian-Oceanian Standard Setters Group (AOSSG) under the current Chairman, Kevin Stevenson, who is also the Chairman of the AASB. Merran Kelsall, Chairman of the AUASB, who is a Member of the International Auditing and Assurance Standards Board (IAASB), has also been very helpful in keeping us up to date with global developments in auditing.

Auditor independence

A key international and local focus affecting auditing and assurance over the past year has been the debate on auditing related issues following the global financial crisis.

These issues include audit quality, the role of the auditor and auditor reporting. There is also a considerably heightened focus on the independence of auditors and greater scrutiny over the scepticism and professional judgement exercised by auditors, and as a consequence, international pressure for greater regulation of auditors. During 2011-12 the FRC continued to monitor the effectiveness of Australia's auditor independence requirements. The FRC performs this work primarily through the use of information obtained from the Australian Securities and Investments Commission (ASIC) and the other bodies with which it has a Memorandum of Understanding (MOU) and through periodic meetings with those bodies and other stakeholders, such as auditing firms.

The FRC anticipates that audit quality will be further improved in response to the refinement of the Australian audit framework in addition to the legislation changes mentioned earlier. The Australian Professional and Ethical Standards Board (APESB) released a revised APES 110 *Code of Ethics for Professional Accountants*, applying from 1 July 2011, which aligned Australia's professional requirements with a revised international code of ethics issued by the International Ethics Standards Board for Accountants (IESBA). From 31 January 2013, ASIC will commence registering Self-Managed Superannuation Fund (SMSF) auditors, and from 1 July 2013 an individual will need to be registered with ASIC to conduct SMSF audits. The Government has announced that registered SMSF auditors will also be required to comply with ongoing auditor independence requirements under APES 110.

The overall conclusion reached by the FRC as a result of its 2011-12 work on auditor independence is that the independence framework in Australia continues to operate effectively and will be further improved in the light of recent audit developments. This is a good position from which to pass on the baton for monitoring and reporting on auditor independence to ASIC, following the legislative changes I mentioned earlier.

Outlook for 2012-13

2012-13 may well prove to be a year of transformation in relation to the global adoption of a single set of high quality accounting standards. The work plans of the IASB and US Financial Accounting Standards Board (FASB) on convergence of specific accounting standards, as mandated by the G20, are likely to reach a conclusion. The stage will then be set for decision makers in the US and Japan to decide whether to join the rest of the world in the use of IFRS or continue to use their own separate accounting standards. Whatever decision they make the rest of the international community is likely to continue to move to more complete adoption of IFRS. This can

only enhance the efficiency with which global capital markets operate and improve the transparency of financial reporting.

It is also likely that 2012-13 will see a number of decisions made regarding the greater regulation of audit arrangements. While the FRC believes our present system is robust we will need to stay abreast of international changes to be prepared for any effects in Australia of these changes.

Several of the FRC's Task Forces will see their current work projects complete in 2012-13 with the release of public reports and the FRC will continue to monitor developments in the strategic areas. The FRC will be conducting a mid-term review of the strategic plan in the 2012-13 reporting year. This review will consider how recommendations offered have been progressed. It may also identify new areas of interest; while conscious that the tight fiscal situation means that the FRC will have to be selective in determining priorities.

Acknowledgements

I would like to acknowledge the contributions of all FRC Members for the generous assistance they have provided and particularly those of the Deputy Chairman Mr Michael Coleman and the Chair of the Nominations Committee Ms Jan West AM who have both undertaken significant work in their roles and who also stepped in to act as Chairmen for the Managing Complexity and Integrated Reporting Task Forces when the previous Chairmen, Mr Bruce Brook and Mr John Stanhope, retired from the FRC. I would also like to note the contributions of Mr Kevin Lewis who led the Board Education Task Force and provided much support from the ASX for its work. Mr Grant Hehir, who led the Public Sector Task Force, was also very helpful in coordinating their efforts, particularly in relation to submissions in relation to International Public Sector Accounting Standards (IPSAS).

Two other very experienced members of the FRC – Mr Michael Dwyer and Mr Klaus Zimmermann – left the FRC during year. We would like to recognise their outstanding contributions, and those of Mr Bruce Brook and Mr John Stanhope, and to note the sad passing of Mr Dwyer on 2 March 2012.

Mr Andrew Fleming, Ms Belinda Gibson and Mr Ian Purchas all joined the FRC during 2011-12 and we look forward to their contributions. Mr Mark Coughlin and Ms Noelle Kelleher were re-appointed to the FRC during 2011-12 and we know that they will continue to make valuable contributions.

The FRC Secretariat provides an important service to ensure the smooth and effective operation of the FRC. During 2011-12, two separate sets of significant changes occurred within the Secretariat. At the end of the first half of 2011-12 the FRC Secretary, Mr Michael Lim, and two other senior members of staff moved to other Treasury areas. I would like to extend my gratitude to Michael for his work with the FRC.

Mr Les Pascoe stepped in as Acting Secretary of the FRC until his retirement in mid-June 2012, and performed a superb job. Les attended the first FRC meeting in October 1999 and provided many years of valuable service before his retirement. Mr Bruce Donald took on the role of Secretary following Mr Les Pascoe. Thanks are given to those Treasury officials who have acted as Secretaries of FRC Committees and Task Forces. Thanks also to Ms Darinka Zubovic for her very effective support for the FRC over the more than ten years she spent with us before her retirement in June 2012.

I have greatly enjoyed my first year as FRC Chairman and I look forward to working with FRC Members and the FRC Secretariat in the coming year to ensure the FRC continues its role in overseeing the effectiveness of the financial reporting framework in Australia.

A handwritten signature in black ink that reads "Lynn Wood". The signature is written in a cursive, flowing style.

Lynn Wood
Chairman of the Financial Reporting Council
18 October 2012

ENQUIRIES

Initial queries relating to the FRC's annual report may be directed to the Secretary of the FRC:

Location: Secretary
Financial Reporting Council
c/ The Treasury
Langton Crescent
PARKES ACT 2600

Telephone: 02 6263 3144
Facsimile: 02 6263 2770
Email: frcsecretary@treasury.gov.au
Website: <http://www.frc.gov.au>

1 OVERSIGHT OF AUSTRALIAN STANDARDS SETTING

1.1 INTRODUCTION

Under the *Australian Securities and Investments Commission Act 2001* (ASIC Act) one of the FRC's functions is to provide broad oversight of the processes for setting accounting and auditing standards in Australia and to give the Minister reports and advice about these processes. Specific accounting and auditing standard setting functions for which the FRC was responsible in 2011-12 are contained in subsections 225(2) and (2A) of the ASIC Act. The activities of the FRC in executing these functions and responsibilities can be grouped as follows:

- activities in relation to the standards setting boards in Australia;
- activities in relation to developments in Australia; and
- activities in relation to international developments.

An outline of each of these three areas is provided in this section of the report in conjunction with information about the FRC's performance of its functions in each area.

1.2 ACTIVITIES IN RELATION TO THE BOARDS

The ASIC Act provides the FRC with a number of responsibilities with respect to the two standards setting boards (the Boards), the AASB and the AUASB. These responsibilities include appointing the members of the Boards, giving them advice on certain areas and determining their broad strategic directions.

1.2.1 Appointment of members to the Boards

The ASIC Act provides that the FRC is responsible for appointing the members of the AASB and AUASB (other than the Chairmen, who are appointed by the Minister). In addition, the ASIC Act provides that the members of the Boards (other than the Chairmen) hold office on the terms and conditions determined by the FRC.

The FRC is assisted in the performance of these functions by a Nominations Committee which is responsible for seeking expressions of interest from persons

interested in being considered for appointment to either the AASB or AUASB and interviewing and evaluating candidates on the basis of merit. The Nominations Committee is also responsible for preparing and conducting the annual members' peer review for the FRC, the AASB and the AUASB. The membership of the Nominations Committee as at 30 June 2012 is listed in the table below.

Committee	Chairman	Members
Nominations Committee	Jan West AM	Lynn Wood Mark Coughlin Merran Kelsall Ian Laughlin Kevin Stevenson

The FRC would like to thank Mr Klaus Zimmermann for his contribution as the previous Chairman of the Nominations Committee. Mr Zimmermann retired from the position at the end of 2011 and has been succeeded by Ms Jan West AM.

The following appointments and re-appointments to the Boards for terms commencing on 1 January 2012 and ending on 31 December 2014 (unless otherwise shown) were approved by the FRC on 14 December 2011:

- AASB: appointment of Ms Liane Papaalias and Carmen Ridley; and the reappointment of Messrs Ian McPhee, John O'Grady and Brett Rix. Mr Victor Clarke was reappointed for two years.
- AUASB: appointment of Professor Nonna Martinov-Bennie and the reappointment of Ms Elizabeth Johnstone and Messrs Colin Murphy and Greg Pound. Mr David Simmonds was reappointed for one year.

The FRC would like to thank the following AASB and AUASB members who left during 2011-12 for their contributions: Mr Glenn Appleyard, Mr Mark Jenkin and Mr Mike Blake.

As at 30 June 2012, the AASB had 14 members while the AUASB had 13 members.

1.2.2 Giving advice or feedback to the Boards and their Offices

The FRC's functions include giving the AASB and AUASB advice or feedback on their priorities, business plans and procedures and giving the Offices of the AASB and AUASB advice or feedback on their budgets and staffing arrangements (including level, structure and composition of staffing).

The FRC monitored the activities of the Boards as part of its regular activities, mainly by asking the Chairmen of the Boards to provide written and oral reports on the Boards' activities at each FRC meeting. The reports provided FRC Members with the

opportunity to raise issues and question the Chairmen about the activities of the Boards at each meeting.

The FRC has this year sought to enhance engagement with both of our standards setters – the AASB and the AUASB. The AASB and AUASB each prepared a strategic plan and sought feedback from the FRC. The FRC established sub-committees to examine and provide comment on the strategic plans. The subcommittee members were:

- (AASB) Ms Lynn Wood, Mr Mark Coughlin, Mr Ian Purchas and Ms Jan West AM;
- (AUASB) Ms Lynn Wood, Mr Bruce Brook, Mr Andrew Fleming and Ms Belinda Gibson.

The FRC Chairman and Secretary attended an AASB meeting at which the AASB Strategic Plan was discussed. The FRC is very pleased with the finalised plans of both Boards and believes they will contribute to ensuring that Australia continues to have an appropriate, robust and dynamic financial reporting framework.

1.2.3 Broad strategic directions of the Boards

The FRC's functions include determining the broad strategic directions of the AASB and AUASB. The FRC has developed guidelines to be applied in the development of any strategic directions that are issued to the Boards (see http://www.frc.gov.au/guidelines/strategic_directions.asp). The guidelines envisage that, in developing and issuing new and revised strategic directions, the FRC will take into account:

- the Australian Government's stated policies and priorities;
- relevant international and domestic considerations impacting on the setting of accounting or auditing standards; and
- the public interest in the context of the Australian economy.

Since its establishment, the FRC has made three determinations concerning the broad strategic directions of the AASB and AUASB. These directions sought to achieve the following key outcomes:

- to require the AASB to work towards the adoption in Australia of accounting standards that are the same as those issued by the IASB, to ensure their applicability to *Corporations Act 2001* (Corporations Act) entities for accounting periods beginning on or after 1 January 2005 (Direction approved 5 September 2002);

- to require the AASB to pursue as an urgent priority the harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting (Direction approved 12 December 2002); and
- to require the AUASB to develop Australian auditing standards that have a clear public interest focus and are of the highest quality and to use, as appropriate, International Standards on Auditing issued by the International Auditing and Assurance Standards Board (IAASB) as a base from which to develop the Australian standards (Direction approved 4 April 2005).

Each of these directions is still current. The FRC, in the course of monitoring the activities of the Boards, did not consider that there was any need to amend the existing directions or issue a new direction.

2 MONITORING AND INFLUENCING AUSTRALIAN DEVELOPMENTS

2.1 INTRODUCTION

The FRC has the following specific responsibilities in respect of Australian accounting and auditing standards:

- promoting the continued adoption of international best practice in the Australian accounting and auditing standard setting processes if doing so would be in the best interests of both the private and public sectors in the Australian economy; and
- monitoring the operation of accounting and auditing standards to assess their continued relevance and their effectiveness in achieving their objectives in respect of both the private and public sectors of the Australian economy and monitoring the effectiveness of the consultative arrangements used by the AASB and AUASB.

In addition to the reports presented by the Chairmen of the Boards at FRC meetings, the FRC also monitored the operation of accounting and auditing standards through regular stakeholder reports presented at FRC meetings by FRC members and through an ongoing program of visits by the FRC Chairman with stakeholders.

2.2 DOMESTIC STAKEHOLDER ENGAGEMENT

Over the past year, the FRC has engaged with domestic stakeholders through a variety of means, including:

- regular meetings and other involvement with stakeholders and interest groups;
- consideration of financial reporting issues in the public and private sectors; and
- consultation with stakeholders – including targeted surveys – on key strategic issues through the work of the FRC Task Forces.

Based on the importance of issues tackled and the quality of responses the FRC Task Forces received during its consultations, the work performed by the FRC has been of significant interest to the financial reporting community in Australia.

The FRC Chairman has regularly met with key stakeholders to discuss financial reporting matters of general interest, obtain feedback on the work of the FRC, explain the activities of the FRC, and discuss matters of particular interest to the stakeholder. In addition she has attended a number of public fora where issues of relevance to the FRC have been discussed.

The FRC Chairman and Secretary both attended AASB and AUASB meetings in July 2011, to present and discuss the FRC Strategic Plan.

The FRC Chairman and Secretary met the then Parliamentary Secretary to the Treasurer, the Hon. David Bradbury MP, in October 2011, to discuss FRC activities including integrated reporting. She also met the Parliamentary Secretary to the Treasurer, the Hon. Bernie Ripoll MP, in April 2012, to discuss the FRC Strategic Plan, oversight of the AASB and AUASB and to invite him to an FRC meeting.

In January 2012 the FRC Chairman met with officials at the Treasury and the Department of Finance and Deregulation to discuss a variety of FRC issues, including the FRC budget and Strategic Plan. In April 2012 she met, along with the Chairmen of the AASB, AUASB and representatives of ASIC, with assessors from the International Monetary Fund (IMF) in connection with Australia's Financial Sector Assessment Program (FSAP). In May 2012, the FRC Chairman met the new General Manager of the Corporations and Capital Markets Division, Treasury, to discuss Treasury's support for the FRC.

In November 2011 the FRC Chairman gave the opening address at the annual meeting of the Asian-Oceanian Standard-Setters Group (AOSSG) in Melbourne, which focused on the adoption of IFRS. In April 2012 the FRC Chairman presented a luncheon address to the Committee for Economic Development of Australia (CEDA). The subject of the address was *Financial Reporting – current and future issues*.

The FRC Chairman attended a meeting of the Business Reporting Leaders Forum (BRLF) in May 2012 to discuss the FRC submission on integrated reporting to the International Integrated Reporting Council (IIRC), and an Institute of Chartered Accountants in Australia (ICAA) event in February 2012 *'The Audit Committee – Evolution and Challenges'*.

She also met a variety of individual stakeholders during 2011-12, including Ms Jan McCahey (PwC), Mr Warren McGregor (AASB), stakeholders from the Business Council of Australia, Group of 100 and the Association of Superannuation Funds of Australia, Ms Nicola Steele from the Australian Institute of Company Directors and Mr Doug Niven of ASIC.

Ken Spencer Memorial Lecture

The 2011 and 2012 Ken Spencer Memorial Lectures were held during the reporting year.

The guest speaker for the 2011 lecture, held in Sydney on 6 September 2011, was the Hon. David M. Walker, Founder and CEO of the Comeback America Initiative and the Former Comptroller General of the United States. The topic of his lecture was *Fiscal Responsibility and Accountability for Sovereign Governments*. The FRC Chairman and Secretary accompanied Mr Walker to Canberra, during his visit to Australia, to discuss matters including international sovereign debt issues, with officials from the Australian Treasury and Department of Finance and Deregulation.

The guest speaker for the 2012 lecture, held in Melbourne on 29 May 2012, was Mr Warren McGregor, former member of the International Accounting Standard Board. The topic of his lecture was *Setting Accounting Standards: Politics, Processes, Philosophies and Personalities – the experience of the IASB*.

2.3 INTEGRATED REPORTING

While much of the focus on integrated reporting is global in nature, following the work of the IIRC, the FRC's Integrated Reporting Task Force has consulted broadly with domestic stakeholders regarding the development of integrated reporting. In particular the Task Force and other FRC members have worked with, and held discussions with: the Minister; other relevant accounting and auditing stakeholders; and other bodies in this space including the BRLF and the Global Reporting Initiative (GRI). The Task Force made a submission to the IIRC's discussion paper *Towards Integrated Reporting: Communicating Value in the 21st Century* in December 2011, and has also been in contact with the Australian participants of the pilot being run by the IIRC.

Mr John Stanhope, the then Chairman of the Task Force presented on the topic of integrated reporting at the first Australian GRI conference held in Melbourne in March 2012.

2.4 MANAGING COMPLEXITY

On 29 May 2012, the Managing Complexity Task Force released a report, which included input from FRC members, and called for submissions from domestic stakeholders by 31 July 2012.

2.5 PROMOTING BOARD EDUCATION

The Board Education Task Force conducted a survey of directors and financial reporting professionals in April and May 2012, working with them to identify if there are any issues in terms of the financial literacy of directors and, if so, how to address them.

2.6 AUDIT QUALITY

The Audit Quality Task Force discussed the implications for the Australian audit framework of a number of international audit developments, including the release of a legislative proposal by the European Commission (EC) responding to consultation on the EC Green Paper *Audit Reform: Lessons from the Crisis* and the development of the IAASB Invitation to Comment *Improving the Auditor's Report*. The Audit Quality Task Force also developed a survey for members of the Australian Shareholders' Association in order to better inform an FRC response to the IAASB paper.

The Task Force had an important role in discussing issues with the Treasury in the development of the Audit Enhancement Act, taking into consideration the implications of recent corporate collapses on the perception and regulation of Australian auditors. The Audit Enhancement Act adds a responsibility for the FRC on these matters.

2.7 PUBLIC SECTOR FINANCIAL REPORTING

The Public Sector Task Force has continued to play an important role in consulting with domestic stakeholders on whether the FRC Strategic Direction relating to public sector accounting (GAAP/GFS harmonisation) is working successfully. The AASB has the responsibility for implementing this strategic direction.

2.8 OTHER MATTERS

A variety of stakeholders have contacted the FRC on financial reporting matters over 2011-12.

The FRC has continued to monitor the work of the AASB surrounding the accounting standards which apply to Small and Medium Sized Entities (SMEs). The AASB introduced a Reduced Disclosure Regime (RDR) for many of these in 2010-11, and it is important that the FRC and AASB continue to verify that this is the most appropriate arrangement for such domestic enterprises.

3 MONITORING AND INFLUENCING REGIONAL AND INTERNATIONAL DEVELOPMENTS

3.1 INTRODUCTION

The *Australian Securities and Investments Commission Act 2001* (ASIC Act) confers on the FRC the following functions associated with the development of international standards:

- monitoring the development of international accounting and auditing standards as well as the accounting and auditing standards that apply in major international financial centres; and
- furthering the development of single sets of accounting and auditing standards for worldwide use with appropriate regard to international developments.

During the 2011-12 year, the FRC has continued to monitor and contribute to a range of activities associated with, or that have the potential to impact on, international accounting and auditing standards setting. These activities include engaging with Australian representatives of key international bodies such as the International Financial Reporting Standards Foundation (IFRS Foundation), the International Accounting Standards Board (IASB), the International Auditing and Assurance Standards Board (IAASB), and the International Public Sector Accounting Standards Board (IPSASB); maintaining contacts with relevant overseas persons and bodies; and by cooperating with the Treasury in contributing to the ongoing global discussions on financial reporting and its role in maintaining stability in the global financial system.

3.2 STAKEHOLDER ENGAGEMENT

During the 2011-12 year, Australian representatives on key international bodies, including Mr Ian Mackintosh, Vice-Chairman of the IASB; Mr Warren McGregor, past member of the IASB; Mr Jeffrey Lucy AM, Trustee of the IFRS Foundation; and Ms Judith Downes, member of the International Financial Reporting Standards Advisory Board (IFRS Advisory Board), were invited to attend one or more FRC meetings to provide updates on international developments and to contribute to FRC discussions at the meeting from the international perspective. A number of FRC members are also represented on, or actively involved with, key international bodies, and provide regular updates to the FRC.

In October 2011, the FRC Chairman and Secretary visited a range of overseas stakeholders in Hong Kong, Paris, Brussels, London, New York and Washington. They met with senior representatives from a broad range of stakeholders, including the Federation of European Accountants, the UK Financial Reporting Council, the European Financial Reporting Advisory Group, the US Securities and Exchange Commission, the Public Company Accounting Oversight Board, the International Federation of Accountants, and the US Financial Accounting Standards Board. The FRC Chairman and Secretary also had the opportunity to attend a meeting of the IFRS Foundation Trustees.

The FRC Chairman also met with representatives from key international bodies on their visits to Australia, including Professor Mervyn King from the International Integrated Reporting Council, Professor Andreas Bergmann, Chairman of the International Public Sector Accounting Standards Board (IPSASB), Mr Stephen Haddrill from the UK Financial Reporting Council, and Mr Ian Mackintosh.

3.3 MONITORING AND INFLUENCING GLOBAL CONVERGENCE

In accordance with its governing legislation, the FRC seeks to support and further the adoption of a single set of global financial reporting standards. The most widely adopted set of accounting standards globally is the International Financial Reporting Standards (IFRS) issued by the IASB for use in the preparation of general purpose financial statements. IFRS has been adopted by over 100 countries around the world, including the members of the European Union and an increasing number of countries in the Asia-Oceania region. Australia was one of the earliest adopters of IFRS, which have been legally enforceable under the *Corporations Act 2001* since 2005, and continues to be a strong advocate of IFRS. The Australian Government, through the FRC, also provided financial support to the work of the IASB through a grant of \$1 million during the 2011-12 year.

The FRC has continued to monitor the work of the IASB, which has continued to focus on the convergence between the accounting standards issued by the IASB and the US Financial Accounting Standards Board (FASB) in the priority areas. During the year, the FRC made submissions to the IASB's agenda consultation, and the IFRS Foundation Trustee's strategy review.

Two G20 summits were held during the year. The Final Declaration from the Cannes Summit, held on 3-4 November 2011, reaffirmed the Group's objective to achieve a single set of high quality accounting standards and called on the IASB and FASB to complete their convergence project. The Declaration also indicated that the Group looks forward to the completion of proposals to reform the IASB governance framework. The Declaration from the Mexico Summit, held on 18-19 June 2012, indicated that the Group supported continuing work to achieve convergence to a

single set of high-quality accounting standards. Convergence issues were discussed with US stakeholders, in particular during the October 2011 overseas trip.

The FRC made a submission in December 2011 to the International Integrated Reporting Council's (IIRC's) Discussion Paper *Integrated Reporting – Communicating Value in the 21st Century*, advocating the need to distinguish financial statements and other issues in an integrated report, and the need for a conceptual framework to underpin future IIRC work.

3.4 MONITORING AND INFLUENCING REGIONAL CONVERGENCE

IFRS Regional Policy Forum

The sixth IFRS Regional Policy Forum was held in Kuala Lumpur, Malaysia, from 26 to 27 March 2012. The Conference was hosted by the Malaysian Accounting Standards Board, and was attended by about 140 participants from 22 jurisdictions and 10 international organisations. Mr Ian Mackintosh, Mr Jeffrey Lucy, and Mr Charles Macek, Vice Chairman of the IFRS Advisory Board, also attended the Forum. In addition, the FRC Chairman, the AASB Chairman, senior Treasury officials and members of the Australian accounting profession were in attendance. Speakers included the FRC Chairman, the AASB Chairman, and a senior representative from Treasury.

The theme of the conference was 'Convergence and Beyond, Navigating Change', and the three focus areas of the Forum were the future of financial reporting standards, the transition to IFRS and the framework for standard setters, regulators and auditors. Attendees discussed the broad strategic direction of the IASB and its future agenda; how market and banking regulators can work together with the IASB to deal with changes in IFRSs to ensure consistent application and interpretation of IFRS, and the broad framework for standard setters and the auditing profession. The need to establish an effective and efficient financial reporting framework for Small and Medium Enterprises were also discussed.

The key outcomes from the Forum were:

- the participants reaffirmed their commitment to the adoption of IFRS recognising that for some jurisdictions this is achieved via a process of convergence;
- participants expressed their appreciation to IASB for its efforts in conducting a thorough and comprehensive consultation on its future agenda. The output from the agenda consultation process is crucial in formulating the strategic direction of IASB and its post convergence work program;
- participants agreed that in working towards a set of globally accepted accounting standards, regulators have to work together not only with IASB but also with

their national standard setters and regional standard setting bodies, to better align local policies with these international standards and to integrate the requirements of the standards into the domestic legal framework; and

- it was also acknowledged that for IFRS to be accepted globally, the standards have to be enforced, implemented, audited and enforced on a consistent basis.

It was agreed that the next IFRS Regional Policy Forum will be hosted in Hong Kong in 2013.

Asian-Oceanian Standards Setters Group (AOSSG)

AOSSG was established in 2009 as a forum to:

- promote the adoption of, and convergence with, IFRSs by jurisdictions in the region;
- promote consistent application of IFRSs by jurisdictions in the region;
- coordinate input from the region to the technical activities of the IASB; and
- co-operate with governments and regulators and other regional and international organisations to improve the quality of financial reporting in the region.

AOSSG is currently chaired by the Chairman of the AASB, and is comprised of 25 member organisations from different jurisdictions within the region. The AASB is one of the most active members of the AOSSG, and makes an important contribution to many of its key projects.

The FRC fully supports AOSSG and its activities, and considers that it is a key instrument in increasing Australia and the region's influence in international accounting standard setting, and for assisting countries within the region to adopt and transition towards IFRS. AOSSG is increasingly seen as providing a valuable balance in IFRS issues to the views of the US and Europe.

The FRC Chairman delivered the opening address to the third annual AOSSG Conference held in Melbourne in November 2011.

3.5 TRANS-TASMAN HARMONISATION

Single Economic Market outcomes framework

On 29 August 2009, the Prime Ministers of Australia and New Zealand agreed on a framework of principles and a range of shared medium term practical outcomes for developing cross border initiatives. A key element within the framework is a

deliberate move from consideration of purely national benefits in policy development, to consideration of the net trans-Tasman benefit.

The key outcomes relating to the financial reporting and audit matters which have been high priority for this year include:

- facilitating the ability of for-profit entities to prepare only one set of financial statements in Australia and New Zealand;
- facilitating the ability of not-for profit entities to use a single set of accounting standards and prepare only one set of financial statements in Australia and New Zealand;
- ensuring that the financial reporting oversight and standards-setting bodies in Australia and New Zealand have functional equivalence; and
- opening up the trans-Tasman market for audit services by allowing auditors registered in one country to operate as though they are registered in the other country.

On 1 July 2011, the outcome relating to ensuring that the financial reporting oversight and standard-setting bodies in Australia and New Zealand have functional equivalence was achieved when the new institutional arrangements for standard-setting in New Zealand came into force. This involved the establishment of the External Reporting Board (XRB), which contains three entities: the XRB Board and two standard setting boards – the New Zealand Accounting Standards Board (NZASB) and the New Zealand Auditing and Assurance Standards Board (NZAuASB). It replaces the former Accounting Standards Review Board (ASRB) and the two former standards setting entities, the Financial Reporting Standards Board (FRSB) and the Professional Standards Board (PSB), both of which were entities established by the New Zealand Institute of Chartered Accountants (NZICA). This structure is similar to the structure in Australia, with the Financial Reporting Council, and the two standards setting boards – the AASB and the AUASB.

The External Reporting Board (XRB) is tasked with the following functions:

- developing and implementing an overall strategy for financial reporting standards and auditing and assurance standards (including developing and implementing tiers of financial reporting and assurance);
- preparing and issuing accounting standards;
- preparing and issuing auditing and assurance standards, including the professional and ethical standards that will govern the professional conduct of auditors; and

- liaising with national and international organisations that exercise functions that correspond with, or are similar to, those conferred on the XRB.

The FRC Chairman and the Secretary attended the inaugural meeting of the XRB Board in Wellington on 1 July 2011. The FRC Chairman was appointed a member of the XRB from that date.

Trans-Tasman Accounting and Auditing Standards Advisory Group (TTAASAG)

Successive FRC Chairmen have been members of TTAASAG, which was established in 2004 to advise the Australian and New Zealand Governments and accounting and auditing standards setters on ways to reduce costs and improve efficiency by aiming for single sets of accounting and auditing standards to apply in both jurisdictions. TTAASAG also seeks to maximise the influence of Australia and New Zealand in the development of international accounting standards and international auditing and assurance standards, including the international standards setting processes supporting the development of those standards.

The FRC Chairman continues to work with other members of TTAASAG to further its objectives.

Cross-memberships with NZ bodies

Following its establishment in 2004, TTAASAG proposed that cross-memberships between relevant standard setting and oversight bodies of Australia and New Zealand would be a desirable step in the process of reducing costs and improving efficiency of businesses operating in both jurisdictions. In 2008-09, TTAASAG reviewed the role of cross-appointees and concluded that they are contributing to the standard setting process by facilitating cooperation and communication.

Cross-appointments for this financial year include:

- The FRC Chairman has been a member of the XRB during the 2011-12 period. Mr Kevin Simpkins, Chairman of the XRB, has been a member of the FRC since June 2009.
- Kevin Stevenson, Chairman of the AASB and FRC member, was a member of the NZASB, while Ms Michele Embling (Chairman of the NZASB) was a member of the AASB.
- Ms Merran Kelsall, Chairman of the AUASB and FRC member, was a member of the NZAUASB, while Mr Neil Cherry (Chairman of the NZAUASB) was a member of the AUASB.

4 MONITORING AUDITOR INDEPENDENCE

4.1 INTRODUCTION

The passage of the *Corporations Legislation Amendment (Audit Enhancement) Act 2012* had significant implications for the functions of the FRC. The Audit Enhancement Act replaced the FRC's auditor independence oversight role with a strategic oversight role regarding audit quality more broadly. As such, the report on the FRC's auditor independence function covers the period from 1 July 2011 to 27 June 2012, the date the Audit Enhancement Act entered into effect. ASIC is the key regulator under the Corporations Act and responsibility for the surveillance, investigation and enforcement of the financial reporting requirements of the Corporations Act, including the enforcement of auditor independence and audit quality requirements.

For this period, the ASIC Act provided that the FRC's functions included monitoring the effectiveness of auditor independence requirements in Australia and the provision of reports and advice about this matter to the Minister. This part of the report has been prepared in accordance with the repealed section 235BA of the ASIC Act as effective until 27 June 2012, which required the FRC to give the Minister a report each year on the performance by the FRC of its auditor independence function.

Australia has comprehensive legislative and professional requirements concerning the independence of auditors. The principal requirements are:

- divisions 3 and 5 of Part 2M.4 of the Corporations Act, which set out the requirements that have to be satisfied by the auditors of those entities that are subject to the audit requirements of the Act;
- auditing standard ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*;
- auditing standard ASQC 1 *Quality control for firms that perform audits and reviews of financial reports and other financial information, and other assurance engagements*;
- section 290 of the *Code of Ethics for Professional Accountants* (APES 110); and
- APES 320 *Quality control for firms*.

Under the Corporations Act, all disclosing entities, public companies (except some companies whose members' liability is limited by guarantee), large proprietary companies and registered schemes are required to prepare financial reports and have them audited. These audits must be conducted by auditors or audit companies registered by ASIC for that purpose.

To complement legislative and professional auditor independence requirements, appropriate institutional arrangements are in place to monitor compliance with those requirements and, where necessary, take appropriate follow-up action. The principal organisations making up these institutional arrangements are Australian Securities and Investments Commission (ASIC), the Australian Securities Exchange (ASX), The Institute of Chartered Accountants in Australia (ICAA), CPA Australia, the Institute of Public Accountants (IPA), the Accounting and Professional Ethics Standards Board (APESB), the Companies Auditors and Liquidators Disciplinary Board (CALDB) and the FRC.

4.2 SYSTEMS AND PROCESSES OF AUSTRALIAN AUDITORS

The ASIC Act required the FRC to monitor and assess the nature and overall adequacy of the systems and processes used by audit firms to ensure compliance with auditor independence requirements.

During the period under review, the FRC performed this function by gathering information from ASIC under the terms of its Memorandum of Understanding (MOU) with that body, by reviewing reports published by the ICAA, by requesting information from the professional accounting bodies under the terms of its MOUs with those bodies and consulting other appropriate bodies with interests in these matters. Whilst ASIC has identified areas for improvement within certain audit firms on the basis of its work during the period covered by this report, the FRC did not become aware of deficiencies in the underlying systems and processes used by audit firms to ensure compliance with auditor independence requirements.

4.2.1 Report from ASIC

The MOU that the FRC has entered into with ASIC provides for periodic consultation and information sharing between the two bodies to assist them in undertaking their respective responsibilities under the law. ASIC's 2011-12 report to the FRC summarises ASIC's observations and findings in relation to the independence systems and processes of selected firms where inspections were either in progress on 1 July 2011 or commenced after that date and were substantially completed by 30 June 2012. As in past years, the report by ASIC constitutes a key source of information for the FRC with respect to its responsibilities in this area during 2011-12.

The last ASIC audit inspection program report was issued in June 2011 and covered findings from the inspection of 21 firms completed in the period between 1 July 2009 and 31 December 2010. The next audit inspection program report will be released in November or December 2012, and will cover the period between 1 January 2011 and 30 June 2012. For the purposes of ASIC's report to the FRC on the 2011-2012 audit

inspection program, ASIC has divided Australian accounting firms into three broad groups:

- **larger national firms** that audit numerous listed entities and are national partnerships or authorised audit companies and members of a global network with multiple offices;
- **other national and network firms** that are national partnerships or authorised audit companies that audit many listed entities and are members of a national or international network; and
- **smaller firms that** audit a limited number of listed entities and have a small number of partners.

During the period ending 30 June 2012, ASIC completed inspections of 11 selected firms: three were *larger national firms*, three were *other national and network firms* and five were *smaller firms*. With the exception of the five *smaller firms*, the firms inspected during the period have been previously inspected at least once, with a large number of these firms being inspected a number of times. One of these inspections was conducted jointly with the Canadian Public Accountability Board (CPAB) and two were conducted jointly with the US Public Company Accounting Oversight Board (PCAOB).

ASIC has informed the FRC that its inspection approach varies between different firms.

- For firms that have been previously inspected a number of times, ASIC focuses on significant changes to independence systems, policies and processes and actions taken by the firms in response to its previous inspection observations and findings.
- Firms visited for the first time are subject to a full review of key quality control systems, policies and processes relating to auditor independence.
- In the case of *smaller firms*, ASIC's consideration of their compliance with the independence requirements of the Corporations Act is limited to high-level enquiries with the firms' leadership and independence-related matters specific to the audit engagement files selected for review.

Summary of ASIC's inspection findings

ASIC has informed the FRC that the firms it had inspected previously continued to maintain or improve their quality control systems, demonstrating their commitment to auditor independence.

Firms have implemented quality control systems to ensure compliance with the independence requirements of the Corporations Act and professional quality control

and ethical standards. The extent and complexity of these systems vary depending on the size and nature of the firm.

However, ASIC has also advised the FRC that it continues to have concerns about the number of findings at inspected firms about independence processes and about contraventions of the rotation and other independence requirements of the Corporations Act.

Larger national firms

Three *larger national firms* were inspected by ASIC during 2011-12. In ASIC's view, the firms inspected have established adequate independence policies and processes to facilitate compliance with auditor independence requirements of the Corporations Act and professional standards. Across the firms inspected, leadership remains committed to an appropriate 'tone at the top' that emphasises the importance of audit independence. ASIC observed findings for the *larger national firms* from ASIC inspections indicate areas for continued improvement in the application of established policies and procedures.

ASIC found two instances of potential perceived threats to independence at one *larger national firm*.

- One instance concerned the decision to change the engagement partner for an ASX listed client and the provision of non-audit services to another ASX listed client. At a minimum, these cases raised concern at ASIC about the appearance of independence.
- At another *larger national firm* ASIC was advised of two rotation breaches where the Engagement Quality Control Reviewer (EQCR) played a significant role for more than five years.

Other national and network firms

Three *other national and network firms* were inspected by ASIC during 2011-12. ASIC found that those firms that have been inspected more than once generally made improvements to their quality control systems. However, ASIC reports that it continues to have concerns about the number of findings at some firms in respect of their independence policies and processes.

In ASIC's opinion, independence is fundamental to the conduct of a quality audit and the leaders of these firms need to ensure that they give strong and clear messages about the importance of independence to set an appropriate 'tone at the top'.

Specific observations made by ASIC as a result of these inspections include:

Independence policies and processes:

- ASIC generally found that the *other national and network* firms it inspected have policies and processes in place to facilitate compliance with the independence requirements of the Corporations Act and professional standards. However, it noted that the completeness and adequacy of the independence policies and processes varied across the firms inspected, reflecting the nature or maturity of the network structure of some of these firms. ASIC has informed the FRC that the independence policies and processes of these firms need improvement to ensure that their policies and processes are consistent with the Corporations Act and professional standards and are applied consistently across the member firms. Specific observations made by ASIC as a result of its inspections of *other national and network* firms included that:
 - one firm needed to update the independence policies and procedures to ensure they reflect all the changes in the revised APES 110 issued in December 2010;
 - one firm did not have a clear process to document the factors (including independence) impacting on remuneration of its directors;
 - the member firms of one network do not have a consistent approach to independence oversight and in some cases do not have a dedicated independence monitoring resource;
 - one firm needs to improve its policies and practices to ensure that all member firms undertake and document independence consultations;
 - one firm should consider implementing a formal system to record relevant relationships and financial interests of partners and senior staff to enable testing of the accuracy and completeness of the annual independence declarations of partners and senior staff; and
 - one firm did not adequately document its consideration of the threats and safeguards to its appearance of independence where a director from the firm appeared at a public hearing, creating a potential advocacy threat which could impact upon the firm's independence.

Testing independence systems

- One of the three *other national and network* firms inspected during the period did not test their independence systems and processes, including the declaration of financial interests, to ensure that they are meeting the requirements of the Corporations Act and professional standards. ASIC has expressed the view that, without an appropriate testing program, firms can only place limited reliance on the effectiveness of their independence systems and processes. It is of the view that where firms are testing their independence systems and processes, the communication of the results of the testing process to all personnel can send a strong and clear message about the importance of independence.

Smaller firms

Five *smaller firms* were inspected by ASIC during the period. ASIC has also informed the FRC that, in conducting its inspections and in determining its observations and findings in respect of the *smaller firms*, it is conscious of their size and nature. However *smaller firms* undertaking audits are still required to comply with their legal and professional obligations.

ASIC found that most of the *smaller firms* inspected had a basic level of independence policies and processes in place. However, its inspections showed areas that could be improved to ensure that the firms are complying with the legal and professional independence requirements.

ASIC observed that one *smaller firm* had breached statutory auditor rotation requirements for two listed audit clients, where both the audit partner and the EQCR had acted in their roles for more than five years. For another three listed audit clients, the approaching deadline for rotation means the *smaller firm* was in danger of further breaches if action was not taken.

ASIC also observed that another *smaller firm* had not considered or put into place appropriate plans to prepare for impending auditor rotation in order to meet the requirements of the Corporations Act.

Other auditor independence matters noted by ASIC

ASIC has also provided the FRC with information about other auditor independence issues that it became aware of outside its regular inspection program. In brief, these issues included:

Conflicts of interest

- ASIC has provided the FRC with an update on two conflicts of interest matters mentioned in its 2011 report to the FRC:
 - In one matter, immediate family members of an auditor (a partner of a smaller firm) held a substantial amount of shares in the company at the time that the auditor signed the audit report. ASIC has referred this matter to the Commonwealth Director of Public Prosecutions (CDPP).
 - In another matter, ASIC noted that an auditor from a *smaller firm* held financial interests in and owed amounts to an audited body. A brief of evidence on this matter has been provided to the CDPP in regard to auditor independence breaches and it is expected that charges will be laid against the auditor.
 - At one *larger national firm*, three auditor's independence declarations were qualified, each and separately due to the larger national firm remunerating a consultant who became a director of an audit client. Subsequent to the larger national firm entering into the consulting arrangements, the three respective individuals became directors of audit clients. These matters were disclosed in the firm's Transparency Report 2011 and reported to ASIC.

Consent to resign as auditor

- ASIC received 16 applications from auditors (eight from *smaller firms*, six from *other national and network firms* and two from *larger national firms*) seeking consent to resign from an audit during the period where the auditor claimed to have lost independence as a result of one of the conflict of interest situations identified in the Corporations Act or professional standards.

ASIC consented to the resignation of the auditor in 11 cases. In the other five cases (three where the audit firm was suing for outstanding fees, one case where the audit firm accepted an engagement to provide non-audit services, and one case where the partner of an audit partner became an officer of the audited body), the audit appointment ceased because of the expiry of the 21 day period specified in subsection 327B(2B) of the Corporations Act. ASIC has informed the FRC that firms need to be aware that creating a deliberate conflict of interest situation is an offence under section 324CM of the Corporations Act.

Auditor rotation requirements

- In April 2012 ASIC accepted an enforceable undertaking from an auditor who had been previously included in ASIC's reports as having played a significant role in an audit client for more than five successive years.

Relief from the auditor rotation requirements

- Under subsection 342A of the Corporations Act ASIC is able to extend the rotation period by one or two years on application by the auditor. ASIC will only grant an extension of the period in exceptional circumstances. ASIC has informed the FRC that during the period it received two applications from auditors seeking an extension of the rotation period under the Corporations Act:
 - In one case, the application was granted on the grounds that the circumstances were exceptional and requiring the auditor to meet the auditor rotation requirements of the Corporations Act would have created unreasonable burden on the audited body.
 - In the second case, the application was refused because no exceptional circumstances were noted.

4.3 QUALITY REVIEW PROGRAMS AND DISCIPLINARY PROCEDURES OF PROFESSIONAL ACCOUNTING BODIES

Under the ASIC Act, the FRC is required to monitor and assess:

- the nature, overall adequacy and effectiveness of: the systems and processes used by the professional accounting bodies for planning and performing quality

assurance reviews of audit work undertaken by Australian auditors to the extent that those reviews relate to auditor independence requirements;

- the action taken in response by auditors who have been subject to such reviews; and
- the action taken by the professional accounting bodies to ensure that auditors are responding appropriately.

In addition, the FRC is required to monitor and assess the nature and overall adequacy of the investigation and disciplinary procedures of the professional accounting bodies as those procedures apply to Australian auditors.

During 2011-12, the FRC continued to meet these requirements by seeking relevant information from the professional accounting bodies and reviewing publicly available material issued by those bodies.

During the year, the FRC did not become aware of any deficiencies in either the systems or processes used by the professional accounting bodies for planning and performing quality reviews of audit work, or in the overall adequacy of their investigation and disciplinary procedures.

4.4 QUALITY REVIEW PROGRAMS

4.4.2 ICAA

ICAA members who hold a Certificate of Public Practice (CPP) are required to undergo the Quality Review Program in accordance with the policies and procedures governing the operation of the Program. The ICAA has informed the FRC that the Program has been designed to assess whether members in public practice have the appropriate quality control policies and procedures in place to comply with professional standards and regulatory requirements.

All practices that sign off on audits requiring registered company auditor (RCA) registration are reviewed at least once every three years. All other practices (including those with an RCA but not conducting RCA audits) are reviewed once every five years. Information provided by the ICAA indicates that during the year ended 30 June 2012, it completed reviews of 412 practices with 76 per cent of total review reports recording either no departures from professional standards or departures from professional standards that are not classified as serious.

The ICAA divides the group of practices that conduct audits into two key types: those that conduct audits under the requirements of the Corporations Act; and those that conduct other types of audits. The reviews conducted during 2011-12 found that two per cent of the practices that conduct Corporations Act audits had no departures

from professional standards. All other practices of each type had departures from professional standards, although these departures were not classified as serious for 67 per cent of the practices that conduct Corporations Act audits and 78 per cent of the practices that undertake other types of audits.

For the purpose of its quality review program, the ICAA divides its members' practices into five size categories: sole practitioners; practices with two of four practitioners; non-mid-tier practices with five or more practitioners; mid-tier practices and the Big 4. The key focus of the Quality Review Program in 2011-12 was the review of audit practices of five major firms. The ICAA has advised the FRC that, as the Audit Quality Review Board¹ (AQRB) has completed its mandate, ICAA reviews of the major firms have recommenced.

The ICAA has informed the FRC that, during the year, it continued to see a trend of members either specialising in audit, or resigning from all audit engagements as members recognise that auditing is an advanced technical skill. The ICAA has expressed the view that this trend reflects the increasing complexity of practice and regulation of audit, requiring a significant investment of practice resources to maintain audit competence.

The ICAA also has informed the FRC that, although overall compliance with the auditing standards continues to improve, based on the results of the 2011-12 reviews its main concern continues to be a lack of documentation in relation to the audit opinion issued or insufficient documentation in a particular audit area.

In the area of auditor independence, the following areas of non-compliance with the requirements of APES 110 Code of Ethics for Professional Accountants were noted:

- no documentation or inadequate documentation when considering threats to independence (11 per cent of the 412 practices reviewed);
- appropriate safeguards were not adequately applied when carrying out auditing and accounting functions for a client (10 per cent of practices reviewed); and
- auditing the SMSF of a partner in their practice (2 per cent of practices reviewed).

1 The AQRB was established in December 2005 to act as an independent review body. The AQRB's primary purpose was to monitor the processes by which participating audit firms seek to ensure their compliance with applicable professional standards and legal obligations in relation to independence and audit quality with respect to financial statement audits of publicly listed entities. Participation in the program was voluntary and available to all Australian audit firms which audited listed companies. The AQRB completed its three year charter in February 2009.

4.4.3 CPA Australia

CPA Australia has advised the FRC that as at 30 June 2012, 5,807 of its members held a CPA Australia Public Practice Certificate (PPC) while 1,076 held an ICAA Practice Certificate. All members who hold a PPC are subject to CPA Australia's Quality Assurance (QA) program. A total of 1,173 members are RCAs.

CPA Australia's QA program adopts a cyclical, risk assessment approach to selecting members for review. Member selection is defined by the following criteria:

- members who receive an unqualified report ('accept report') are reviewed after four years except where they are RCAs, in which case they are reviewed after three years;
- members who are required to provide assurances prior to acceptance of the report ('assurance report') are reviewed after three years; and
- members who are subject to a further review because of non-compliance issues are reviewed in the following year.

Every type of public accounting service offered by a member is reviewed by a specially trained QA Reviewer using questionnaires specific to the particular type of service as part of the file review process. QA Reviewers participate in ongoing face-to-face training programs supported by regular updates on standard changes and observations from the program. All questionnaires and working papers that form the basis of a review program are updated regularly to reflect changes to auditing and assurance standards, professional standards and relevant legislation and regulations.

In 2011-12, the reviews conducted under CPA Australia's QA program found that 81 per cent of those reviewed were either fully compliant or had only minor departures from professional standards.

During 2011-12, 58 breaches of auditor independence requirements were identified, with the vast majority relating to audits of SMSFs.

For the 2012 calendar year, over 1,178 members (including 60 RCAs) are expected to complete a QA review. In addition, 129 follow-up reviews (including 17 of RCAs) are expected to be completed.

From 1 July 2011, CPA Australia members were required to adhere to the revised *APES 110 Code of Ethics for Professional Accountants*. The updated code aligns Australia's professional requirements with international standards and includes Australian specific requirements relating to inadvertent violations and multiple threats to auditor's independence.

No issues related to the revised code were identified in the APESB six monthly review process in February 2012 and CPA Australia has not identified any issues subsequently. The code will be reviewed again in February 2013.

4.4.4 IPA

The IPA has informed the FRC that it requires all members who are issued with a PPC to undertake a Public Practice Quality Assurance Review (PPQA) every three to five years. Members who are Australian auditors must be reviewed every three years.

In the period 1 July 2011 to 30 June 2012, the IPA undertook over 500 PPQA reviews of PPC members. The IPA has advised that, to the best of its knowledge, none of the reviews undertaken during this period involved an Australian auditor.

The IPA has also informed the FRC that it has a policy that any joint members (that is, those who are a CPA Australia or ICAA member) who have been subject to a PPQA by their other body in the last two years are exempt from the IPA PPQA. The purpose of this is to avoid the member being excessively audited on the same issue.

For the financial year 2011-12, all reviews were conducted in part using an online data collection program in relation to member practice and their client base. Reviews are still undertaken in a face to face situation and members must provide proof of their compliance with professional and ethical requirements of the IPA. The IPA has advised the FRC that it anticipates the new system will assist it in reporting on members, including Australian auditors.

4.5 DISCIPLINARY PROCEDURES

The professional accounting bodies have provided the FRC with the following information concerning disciplinary matters for the year ended 30 June 2012:

- The ICAA has informed the FRC that during the year ended 30 June 2012 there were no disciplinary cases involving a breach of the ICAA's auditor independence requirements. No ICAA members were referred to the CALDB for issues relating to auditor independence during the reporting period.
- CPA Australia has advised that its Disciplinary Tribunal made three adverse findings against members relating to auditor independence. All of these adverse findings related to audits of SMSFs by non-RCAs. There were no disciplinary actions taken against RCAs in respect of auditor independence. The outcomes of all professional conduct complaints heard by a Disciplinary Tribunal have been published on CPA Australia's website. No CPA Australia members received an adverse finding from the CALDB during the reporting period.

- The IPA reports that it has not taken any disciplinary action in 2011-12 against any members who have identified themselves as Australian auditors. The IPA also reported that it did not investigate any complaints about members who are Australian auditors in relation to a breach of the IPA's independence requirements.
- None of the professional accounting bodies are aware of the referral of any members to the CALDB during the year ended 30 June 2012 for a breach of auditor independence requirements.

4.6 TEACHING OF ETHICS BY THE PROFESSIONAL ACCOUNTING BODIES

The ASIC Act requires the FRC to promote, and monitor the adequacy of, the teaching of professional and business ethics by, or on behalf of, the professional accounting bodies to the extent to which the teaching of those subjects relates to auditor independence.

During 2011-12, the FRC monitored the adequacy of the teaching of ethics by obtaining relevant information from the professional accounting bodies. On the basis of the information supplied by the bodies, the FRC considers that the teaching of ethics by each of the bodies continues to be adequate.

4.7 AUDIT-RELATED DISCLOSURE REQUIREMENTS

Before the legislative changes, the FRC was required by the ASIC Act to monitor the overall compliance by companies, registered managed investment schemes and disclosing entities with audit-related disclosure requirements of the Corporations Act and the accounting standards. A summary of these requirements is provided in Appendix E.

The MOU between the FRC and ASIC provided for ASIC to give the FRC regular reports identifying matters arising from its financial reporting or auditor surveillance activities in relation to compliance by auditors and companies with the independence disclosure requirements in Part 2M.3 of the Corporations Act. The MOU with the ASX also provides for that body and the FRC to exchange information.

ASIC has informed the FRC that, as part of its financial reporting surveillance program, it examined independence declarations under section 307C of the Corporations Act for 480 listed entities for financial years ended on 30 June 2011 and 31 December 2011. Section 307C independence declarations were also examined as part of its audit inspection program. ASIC has reported that no auditor independence issues were noted from these reviews.

In addition, ASX informed the FRC that its technical review of financial reports lodged with it included an examination of the form and location in the financial reports of the auditor independence declarations required under section 307C of the Corporations Act and disclosed by directors under subsections 298(1) and 306(2) of the Act. The ASX's June 2010 and December 2010 reviews found that the preferred format continued to be for the declaration to be presented as a separate attachment to the directors' report.

4.8 INTERNATIONAL DEVELOPMENTS IN AUDITOR INDEPENDENCE

Until the entry into force of the legislative amendments on 27 June 2012, paragraph 225(2B)(e) of the ASIC Act provided that the FRC was to monitor international developments in auditor independence, assess the adequacy of the Australian auditor independence requirements provided for in the Corporations Act and the codes of professional conduct in the light of those developments and give the Minister, and the professional accounting bodies, reports and advise on any additional measures needed to enhance the independence of Australian auditors.

The FRC undertook this function through the monitoring and consideration of general media reports about audit independence issues, as well as material placed on the internet websites of key overseas oversight and standards setting bodies and other regulatory agencies.

During 2011-12, the FRC has observed with interest a range of developments in Europe and North America that have implications for both auditor independence and the broader issue of audit quality. The more significant of these developments include:

- The UK Financial Reporting Council updates to the UK Corporate Governance Code in response to consultation in April 2012 continues to apply on a 'comply or explain' basis. Included in the amended Code is the requirement that FTSE 350 companies put the external audit contract out to tender at least every ten years; more informative reporting by audit committees, including on the process for appointing the external auditor will be encouraged; Boards will set out in the annual report why they consider the report to be fair, balanced and understandable; and audit committees will expressly advise boards on this issue.
- The IAASB Invitation to Comment *Improving the Auditor's Report*, in June 2012. The IAASB's paper was issued in June 2012 and sets out proposals for improving the usefulness of the auditor's report with a view to implementing revised final auditing standards in mid-2014.
- The European Commission (EC) legislative proposal to improve the quality of audits of public-interest entities in November 2011. The proposal was released on 30 November 2011 and follows consultation on the EC's Green Paper *Audit Policy – Lessons from the Crisis*, which sought to address shortcomings in the European audit system identified by the Global Financial crisis. The proposals in the paper

could have global implications in relation to the regulation of audit firms and the way that those firms conduct their practices. The EC process is still in its early stages, and the final legislation is not expected for a couple of years.

- The US Public Company Accounting Oversight Board (PCAOB) released a concept release dated 16 August 2011 on auditor independence and audit firm rotation in August 2011.
- The PCAOB is expected to finalise in 2012 its proposed auditing standard related to communications with audit committees which addresses certain areas for which no corresponding requirements exist in international auditing standards namely; significant issues discussed with management in connection with the auditor's appointment or retention; the auditor's evaluation of the quality of the company's financial reporting; and expanded discussions regarding significant and unusual transactions, the auditor's work with respect to going concern, and uncorrected and corrected misstatements.

The FRC will maintain a watching brief on these developments to determine whether to respond to these developments and will actively engage with stakeholders in its 2012-13 overseas trips.

5 GOVERNANCE AND ADMINISTRATION

5.1 ESTABLISHMENT, FUNCTIONS AND POWERS

The FRC is the peak body responsible for overseeing the effectiveness of the financial reporting framework in Australia. Its key functions include the oversight of the accounting and auditing standards setting processes for the public and private sectors, providing strategic advice in relation to the quality of audits conducted by Australian auditors, and advising the Minister on these and related matters to the extent that they affect the financial reporting framework in Australia.

The FRC monitors the development of international accounting and auditing standards, works to promote the development of a single set of accounting and auditing standards for worldwide use and promotes the adoption of these standards.

The FRC operates within a framework set out in Part 12 of the ASIC Act. The ASIC Act sets out core objectives for accounting and auditing standards setting in Australia:

- Accounting standards should facilitate the Australian economy by reducing the cost of capital and enabling Australian entities to compete effectively overseas, and should maintain investor confidence in the Australian economy, including its capital markets.
- Accounting and auditing standards should facilitate the Australian economy by being clearly stated and easy to understand.

The ASIC Act expressly limits the FRC's ability to become involved in the technical deliberations of the AASB and AUASB. In particular, it provides that the FRC does not have power to direct the AASB or AUASB in relation to the development, or making, of a particular standard, or to veto a standard formulated or recommended by the AASB or AUASB. This provision is designed to ensure the independence of the standard setters.

5.2 MEMBERSHIP AND MEETINGS

Under section 235A of the ASIC Act, the members of the FRC are appointed by the Minister on a part-time basis and hold office on terms and conditions determined by the Minister. Most members of the FRC have been appointed on the basis of nominations put forward by key stakeholder groups.

As at 30 June 2012, the FRC had 17 members. During 2011-12, four members left the Board and three new members were appointed. A full list of members during 2011-12, and the stakeholders who nominated them, is in Appendix A.

Four meetings of the FRC were held during 2011-12.

5.3 CONSULTANTS

During 2011-12, no consultants were engaged to perform work on behalf of the FRC.

5.4 COMMUNICATION AND CONSULTATION

The FRC uses its internet website (www.frc.gov.au) and meetings with stakeholders and other interest groups as its primary means of communication and consultation.

Following each FRC meeting, information about the decisions taken at the meeting is placed on the FRC's website. The FRC's website also includes information about the FRC's members, minutes of past FRC meetings, reports published by the FRC and its procedural rules.

5.5 FINANCES

In 2011-12, the Australian Government provided funding through the Treasury for the purposes of the FRC. As the FRC's Secretariat is provided by staff of the Treasury's Markets Group, expenditures in connection with the FRC and the performance of its functions are included in the Treasury's annual financial statements.

Particulars of the funding for the AASB and AUASB (including the sources of that funding) are included in the separate reports of the AASB and AUASB.

5.6 FREEDOM OF INFORMATION

Since 1 May 2011, agencies subject to the *Freedom of Information Act 1982* (FOI Act) have been required to publish information to the public as part of the Information Publication Scheme. This requirement is in Part II of the FOI Act and has replaced the former requirement to publish a section 8 statement in an annual report. All information published by the FRC can be accessed from links on the home page of the FRC's website.

The FRC did not receive any applications for access to documents under the FOI Act during 2011-12.

5.7 REGULATORY IMPACT STATEMENTS

The FRC did not submit any Regulatory Impact Statements in 2011-12.

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APPENDIX A: MEMBERS OF THE FINANCIAL REPORTING COUNCIL 1 JULY 2011 TO 30 JUNE 2012

Chairman

Lynn Wood
Company Director, Sydney
Nominated by the Australian Government
Term(s): 11 March 2011 to 10 March 2014

Deputy Chairman

Michael Coleman
Company Director, Sydney
Nominated by the Australian Institute of Company Directors
Term(s): 22 September 2006 to 31 October 2009; 14 December 2009 to 13 December 2012

Members

Bruce Brook
Company Director, Melbourne
Nominated by the Business Council of Australia
Term(s): 7 March 2006 to 6 March 2009; 6 April 2009 to 5 July 2009; 3 June 2009 to 2 June 2012

Mark Coughlin
Partner, PricewaterhouseCoopers, Adelaide
Nominated by CPA Australia
Term(s): 22 September 2006 to 31 October 2009; 14 December 2009 to 30 May 2012; 31 May 2012 to 30 August 2012

Michael Dwyer
Member, Australian Securities and Investments Commission, Melbourne
Nominated by the Australian Securities and Investments Commission
Term(s): 3 June 2009 to 11 December 2011

Andrew Fleming
Deputy Head, Australian Equities, Schroders Investment, Sydney
Nominated by the Financial Services Council
Term(s): 24 October 2011 to 23 October 2014

Belinda Gibson
Deputy Chairperson, Australian Securities and Investments Commission, Melbourne
Nominated by the Australian Securities and Investments Commission
Term(s): 10 May 2012 to 5 May 2013

Grant Hehir
Secretary, Victorian Department of Treasury and Finance, Melbourne
Nominated by Heads of State and Territory Treasuries
Term(s): 14 March 2011 to 13 March 2014

Stein Helgeby
Deputy Secretary, Financial Management Group, Department of Finance and Deregulation, Canberra
Nominated by the Australian Government
Term(s): 24 February 2010 to 23 February 2013

Members (continued)

Noelle Kelleher	Partner, Deloitte Touche Tohmatsu, Melbourne Nominated by the Association of Superannuation Funds of Australia Term(s): 3 June 2009 to 30 May 2012; 31 May 2012 to 30 August 2012
Merran Kelsall	Chairman, Auditing and Assurance Standards Board, Melbourne Nominated by the Australian Government Term(s): 29 July 2008 to 9 August 2010; 7 January 2011 to 6 April 2011; 14 March 2011 to 9 August 2013
Vas Kolesnikoff	Chief Executive Officer, Australian Shareholders' Association Nominated by the Australian Shareholders' Association Term(s): 5 April 2011 to 4 April 2014
Ian Laughlin	Member, Australian Prudential Regulation Authority Nominated by Australian Prudential Regulation Authority Term(s): 1 July 2010 to 30 June 2013
Kevin Lewis	Chief Compliance Officer, Australian Securities Exchange, Sydney Nominated by the Australian Securities Exchange Term(s): 14 March 2011 to 13 March 2014
Jim Murphy	Executive Director, Markets Group, Australian Treasury, Canberra Nominated by the Australian Government Term(s): 7 March 2003 to 6 March 2006; 7 March 2006 to 6 March 2009; 3 June 2009 to 30 May 2012; 31 May 2012 to 30 August 2012
Ian Purchas	Principal, RMG Partners Business Solutions, Sydney Nominated by the Institute of Public Accountants Term(s): 10 May 2012 to 9 March 2015
Kevin Simpkins	Chair, External Reporting Board of New Zealand, Wellington Nominated by the New Zealand Minister of Commerce Term(s): 3 June 2009 to 28 February 2014
John Stanhope	Company director, Melbourne Nominated by the Group of 100 Inc Term(s): 6 March 2006 to 26 February 2009; 6 April 2009 to 5 July 2009; 2 June 2009 to 2 June 2012
Kevin Stevenson	Chairman, Australian Accounting Standards Board Nominated by the Australian Government Term(s): 1 July 2009 to 30 June 2014
Jan West AM	Company director, Melbourne Nominated by The Institute of Chartered Accountants in Australia Term(s): 7 March 2005 to 6 March 2008; 29 July 2008 to 28 July 2011; 29 July 2011 to 28 July 2014
Klaus Zimmermann	Chief Executive Officer, Eldercare Incorporated, Adelaide Nominated by the Institute of Public Accountants Term(s): March 2003 to 6 March 2006; 7 March 2006 to 6 March 2009; 6 April 2009 to 5 July 2009; 3 June 2009 to 14 December 2011

APPENDIX B: FRC Strategic Plan 2011-2014

1. FRC PURPOSE AND FUNCTIONS

The Financial Reporting Council (FRC) is the peak body responsible for overseeing the effectiveness of the financial reporting framework in Australia.

Its key functions include the oversight of the accounting and auditing standards setting processes for the public and private sectors, monitoring the effectiveness of the auditor independence regime, and advising the Minister on these matters (see www.frc.gov.au for more information).

It is a statutory body under Part 12 of the *Australian Securities and Investments Commission Act 2001*.

2. FRC STAKEHOLDERS

The FRC has a wide range of stakeholders including a broad spectrum of preparers and users of financial statements, the Commonwealth as well as State and Territory governments, and other government bodies such as standard setters and regulators. Key stakeholder bodies are represented on the FRC as Members (see Appendix B).

In addition, the Australian and New Zealand governments have established cross-appointment arrangements to promote closer economic relationships between the two countries. The FRC accordingly has a New Zealand representative as one of its Members.

3. Environmental analysis

General²

The Global Financial Crisis has accelerated the transition of economic gravity from 'advanced' to 'emerging' economies:

- growth in most 'advanced' economies will be constrained by public and/or household debt burdens; and
- by contrast most major developing economies have already returned to 'trend' growth, are not troubled by unsustainable public debts, and instead have to deal with inflationary pressures and potential asset price bubbles.

Unlike most other 'advanced' economies, Australia stands to benefit significantly from this changing pattern of global economic activity, given our resources endowment and existing strong trade links with Asia.

- There are some risks around our high levels of household and foreign debt, but Australia does not have a significant public debt problem.

Australia's economic challenge is to maximize the long-term benefits from the 'resources boom' whilst minimizing inflationary pressures:

- Australia's 'terms of trade' are at their highest sustained level in at least 140 years and mining investment is now larger, as a proportion of GDP, than at any time in the last 150 years;
- labour shortages are a critical problem, requiring short term and longer term solutions such as greater participation, immigration and skills training; and
- the Reserve Bank's forecasts envisage above-trend growth from this year through 2013, and inflation heading towards the top of the target range. Interest rates and the A\$ will remain above historic averages as part of this process.

Financial reporting

- One of the impacts of the Global Financial Crisis has been to draw the attention of governments and international bodies such as the G20 and the Financial Stability Board to the importance of having sound and internationally consistent financial reporting standards. The clearest sign of this was the G20's call for a single set of high-quality global accounting standards.

² The material in this section is based on a summary provided by Professor the Hon Stephen Martin, Chief Executive, CEDA, following CEDA's Economic and Political Overview 2011 series.

- Australia adopted International Financial Reporting Standards (IFRS) in 2005, and its auditing standards are based on the international standards issued by the International Auditing and Assurance Standards Board.
- Australia's financial reporting environment is becoming steadily more complex as international developments increasingly impinge on its accounting and auditing standards and their broader markets and regulation. Over time there is a strong tendency for outside organisations to seek to add to the financial reporting requirements. The FRC will seek to ensure that the broader interests of the system – of providing critical information to the stakeholders of the entities affected – are preserved in these processes.

4. SWOT ANALYSIS — FINANCIAL REPORTING FRAMEWORK

This analysis refers to the financial reporting framework in Australia as a whole.

Strengths

- Forms part of a system of globalised standards reflecting international best practice.
- Held up well during the Global Financial Crisis.
- Has provided valuable assistance to Australian corporations in accessing global financial markets.
- Australia and New Zealand play a leading role in the development of public sector financial reporting.

Weaknesses

- Not all areas are given equal attention and priority in developing international standards, for example, some issues relating to financial reporting for the public sector and not-for-profits in the private sector have needed renewed focus.
- Exclusive focus on financial reporting, neglecting to some extent the wider context in which economic entities operate.
- Complexity and length of annual reports, due to a variety of reasons, for example, extensive disclosure requirements (remuneration report etc.).
- Level of financial literacy among users, including company directors, leading to issues such as expectation gaps for audit reports.

Opportunities

- Strong political pressure, for example, from G20, to introduce global standards in financial reporting.
- Increasing acceptance of global standards with more key countries close to adopting IFRS.
- A wide range of initiatives, both globally and domestically, supporting integrated reporting to widen the scope of information provided to stakeholders.
- Review of audit regulation by government.
- Potential to influence the debate in relation to public sector and private sector not-for-profit financial reporting at a time when the International Accounting Standards Board (IASB) is not giving attention to those areas and the International Public Sector Accounting Standards Board is still developing its standards, known as International Public Sector Accounting Standards (IPSAS).

Threats

- Risk of fragmentation of the global IFRS community if the USA does not decide to adopt.
- Discussion of radical proposals to regulate audit practices, for example, in the European Union (compulsory joint audits, audit firm rotation etc.).
- Failure of a big 4 accounting firm, potentially leading to a lack of competition in the audit market.
- Complexity caused by Australia's federal structure, and the failure to agree key reforms with the States and Territories, for example, in relation to financial reporting for not-for-profit entities.
- Plethora of narrow additional financial reporting burdens being advocated, for example, as part of a Corporate Social Responsibility or Environmental, Social and Governance agenda, without consideration as to their broader appropriateness.

5. KEY STRATEGIC ISSUES

The key strategic issues faced by the FRC are the following:

- how to assume a thought leadership position in the debate about integrated reporting;

- how to reduce complexity in financial reporting;
- how to improve financial literacy among company directors;
- how to encourage the wider adoption of IFRS globally and in Asia Oceania;
- how to promote a united approach in Australia among key stakeholders in supporting and improving the financial reporting framework and standards;
- how to monitor the effectiveness of auditor independence and other audit quality drivers;
- how to best meet the needs of users of profit-oriented and not-for-profit entities (both private and public sector); and
- how to reduce the regulatory burden on entities preparing financial statements without increasing the risks of inappropriate reporting.

6. ACTION PLAN

As part of the 2010 Peer Review process, Members were asked to comment on the operation of the FRC and potential improvements.

Responses from Members showed that the FRC had particular strength in the work undertaken on IFRS differential reporting, as well as SME (small and medium enterprises), and public sector issues and Members being involved at meetings through stakeholder representation.

Members indicated that they would like the FRC to establish a sub-committee for public sector issues, provide independent advice to the Minister, more clearly define the oversight role in respect of the Australian Accounting Standards Board (AASB) and Auditing and Assurance Standards Board (AUASB) and improve communication with the market about the FRC's activities.

Members are happy with the current skill sets shown by the FRC, however indicated that it may now be too large.

To improve the performance of the FRC, Members would like it to be more proactive in domestic debates and have a more formal process on stakeholder issues.

To improve the effectiveness of the FRC, and in response to the proposals put forward by Members during the Peer Review, it is proposed that the FRC defines a range of projects addressing the key strategic issues.

It is proposed to separate the projects into two categories, the first consisting of priority projects in which the FRC will take a thought leadership role. In general, it is proposed to progress these projects by establishing task forces of three or more Members, including a chairman who is a member of the FRC and possibly selected non-Members, to work on them with the support, where necessary, of the FRC Secretariat. It would be up to the task forces to decide the best way of taking the projects forward, for example by issuing consultation papers through the FRC, cooperating with external stakeholders and/or engaging consultants to deliver specific outputs.

For the other projects, the FRC proposes to play a supporting role.

Priority projects

Project description	Method of implementation	Timing
Reducing complexity in financial reporting	<p>Establishment of a task force (Integrated Reporting Task Force)</p> <p>The initial task will be to recommend an appropriate course of action for the FRC given there is already a significant level of activity in this area. A related issue is the question of how the FRC should position itself relative to organisations already active in the debate in Australia.</p>	<p>Task force to be established as soon as possible following the 18 April FRC meeting. First progress report delivered at the June FRC meeting.</p>
Promoting board understanding of financial reporting	<p>Establishment of a task force (Reducing Complexity Task Force)</p> <p>The initial task will be to identify areas of complexity which can be addressed in Australia, for example multiple sources of financial reporting requirements (including assurance) and executive remuneration.</p>	<p>Task force to be established at the June FRC meeting. First progress report delivered at the September FRC meeting.</p>
Monitoring of audit independence and other audit quality drivers	<p>Establishment of a task force (Board Education Task Force)</p>	<p>Task force to be established at the June FRC meeting. First progress report delivered at the September FRC meeting.</p>
Public sector financial reporting, including evaluation of IPSAS	<p>Establishment of a task force (Audit Quality Task Force)</p> <p>Given the IASB's focus on other priorities, the key issue would be to develop recommendations on appropriate action in the meantime.</p>	<p>Task force to be established at the June FRC meeting. First progress report delivered at the September FRC meeting.</p>
Public sector financial reporting, including evaluation of IPSAS	<p>Establishment of a task force (Public Sector Task Force)</p> <p>Given the IASB's focus on other priorities, the key issue would be to develop recommendations on appropriate action in the meantime.</p>	<p>Task force to be established as soon as possible following the 18 April FRC meeting. First progress report delivered at the June FRC meeting.</p>

As a separate project, which cuts across the other initiatives, it is proposed to enhance the current FRC website. The main purpose would be to make it a useful source of information to the public on financial reporting in general, but especially in relation to the priority projects undertaken by the FRC committees.

The task forces would therefore be expected to consider the use of the website as part of their project, for example by placing useful material on it, including reports and other research, project updates and other relevant material.

Other projects (supporting role)

Project description

Oversight of standard setting processes and providing feedback/advice to the boards

Influencing convergence globally and in the region

Method of implementation

Provision of relevant reports to the FRC, with responses provided as and when necessary

Responding to relevant consultations, for example, by IASB or the Monitoring Board.

Support for relevant AASB and AUASB activities, for example, Asia-Oceania Standard-Setters Group (AOSSG) annual meeting.

Visits to regional and global partners.

Support for relevant events such as the Regional Policy Forum and the recent IFRS seminar in Japan.

Timing

Ongoing

Ongoing

Trans-Tasman harmonisation

Provision of relevant reports to the FRC

Ongoing

Monitoring private sector not-for-profit financial reporting developments

Secretariat to maintain contact with relevant Treasury units working on private sector not-for-profits (NFPs) reform.

Provision of reports to the FRC on developments.

Includes the issue of multiple sources of financial reporting requirements creating complexity and excessive regulatory burdens for private sector NFPs.

Project may be elevated to a higher priority at the appropriate time.

Ongoing

Monitoring the reform of auditing and other requirements as part of the Government's response to the Cooper report

Secretariat to maintain contact with relevant Treasury units working on the Government's response.

Provision of reports to the FRC on developments.

Ongoing

Monitor and Influence G20 and FSB developments

Secretariat to maintain contact with relevant Treasury units.

Provision of reports to the FRC on developments and advice from relevant members.

Ongoing

Consultation documents involving financial reporting issues

For discussion in FRC.

Members may provide written views for inclusion on the meeting agenda for discussion in the FRC.

FRC may respond depending on members' views.

Ongoing

This plan will be reviewed once in every year.

APPENDIX C: Attendance at meetings

FINANCIAL REPORTING COUNCIL

The FRC held four regular meetings during 2011-12. Members' attendance is shown in the table:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
L Wood (Chairman)	4	4	0
B Brook	4	3	1
M Coleman	4	4	0
M Coughlin	4	4	0
M Dwyer (a)	1	1	0
A Fleming	3	3	0
B Gibson (b)	1	1	0
G Hehir (c)	4	2	2
S Helgeby	4	4	0
N Kelleher	4	4	0
M Kelsall	4	4	0
V Kolesnikoff	4	4	0
I Laughlin	4	4	0
K Lewis	4	4	0
J Murphy	4	4	0
I Purchas (d)	1	1	0
K Simpkins	4	3	1
J Stanhope	4	4	0
K Stevenson	4	3	1
J West AM	4	4	0
K Zimmermann	2	2	0

(a) Following the termination of his term on the FRC on 11 December 2011, Mr Dwyer attended one additional meeting as an observer.

(b) Prior to her appointment to the FRC on 10 May 2012, Ms Gibson attended one meeting as an observer.

(c) Represented at one meeting by Mr Steve Mitsas.

(d) Prior to his appointment to the FRC on 10 May 2012, Mr Purchas attended one meeting as an observer.

FRC NOMINATIONS COMMITTEE

The FRC Nominations Committee held five formal meetings in 2011-12. Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
J West AM (Chairman)	5	5	0
M Coughlin	5	5	0
M Kelsall	5	4	1
I Laughlin	3	2	1
K Stevenson	5	5	0
L Wood	5	3	2
K Zimmermann	1	1	0

FRC TASK FORCES

The membership of the FRC Task Forces during the 2011-12 year is shown in the table below, followed by information about meetings of the FRC Task Forces and the attendance of Task Force members at these meetings.

Task Force	Chairman	FRC Members	Non-FRC Members
Audit Quality	Michael Coleman	Mark Coughlin Belinda Gibson (from May 2012) Noelle Kelleher Merran Kelsall Vas Kolesnikoff	Lee White (from Aug 2011)
Board Education	Kevin Lewis	Andrew Fleming (from May 2012) Ian Laughlin Ian Purchas (from May 2012) Klaus Zimmermann (to Dec 2011)	
Integrated Reporting	John Stanhope (a)	Merran Kelsall Kevin Simpkins Kevin Stevenson Jan West AM (b)	John Stanhope (a)
Managing Complexity	Bruce Brook (c)	Michael Coleman (b) Michael Dwyer (to Dec 2011) Kevin Stevenson	Tanya Branwhite Judith Downes Rob Ward (Jul — Oct 2011)
Public Sector	Grant Hehir	Stein Helgeby Kevin Simpkins Kevin Stevenson	Robert Williams

(a) Term on FRC expired on 2 June 2012, and remained on the Task Force as a non-FRC Member.

(b) Appointed Acting Chairman of Task Force following retirement of previous Chair from the FRC.

(c) Term on FRC expired on 2 June 2012.

AUDIT QUALITY TASK FORCE

This Task Force held five formal meetings in 2011-12. FRC Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
M Coleman (Chairman)	5	5	0
B Gibson	1	1	0
M Coughlin	5	2	3
M Kelsall	5	5	0
N Kelleher	5	4	1
V Kolesnikoff	5	4	1

BOARD EDUCATION TASK FORCE

This Task Force held three formal meetings in 2011-12. FRC Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
K Lewis (Chairman)	3	3	0
A Fleming	0	0	0
I Laughlin	3	3	0
I Purchas	0	0	0
K Zimmermann	3	2	1

INTEGRATED REPORTING TASK FORCE

This Task Force held five formal meetings in 2011-12. FRC Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
J Stanhope (Chairman until 2 June 2012)	5	5	0
J West AM (Acting Chairman from 3 June 2012)	5	5	0
M Kelsall	5	5	0
K Simpkins	5	4	1
K Stevenson	5	2	3

MANAGING COMPLEXITY TASK FORCE

This Task Force held three formal meetings in 2011-12. FRC Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
B Brook (Chairman until 2 June 2012)	3	3	0
M Coleman (Acting Chairman since 3 June 2012)	3	3	0
M Dwyer (a)	2	2	0
K Stevenson	3	3	0

(a) Following the termination of his term on the FRC on 11 December 2011, Mr Dwyer attended one additional meeting as an observer.

PUBLIC SECTOR TASK FORCE

This Task Force held three formal meetings in 2011-12. FRC Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
G Hehir (Chairman)	3	3	0
K Stevenson	3	3	0
S Helgeby	3	3	0
K Simpkins	3	2	1

APPENDIX D: Abbreviations

The following abbreviations are used throughout this report:

AASB	Australian Accounting Standards Board
AOSSG	Asian-Oceanian Standards Setters Group
APES	Accounting Professional and Ethical Standard
APESB	Accounting Professional and Ethical Standards Board
AQRB	Audit Quality Review Board
ASA	Australian Auditing Standard
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
ASQC	Australian Quality Control Standard
ASRB	Accounting Standards Review Board (of New Zealand)
ASX	Australian Securities Exchange
AUASB	Auditing and Assurance Standards Board
CALDB	Companies Auditors and Liquidators Disciplinary Board
Corporations Act	<i>Corporations Act 2001</i>
CPP	Certificate of Public Practice
EC	European Commission
FASB	Financial Accounting Standards Board (of the USA)
FRC	Financial Reporting Council
FRSB	Financial Reporting Standards Board (of New Zealand)

Abbreviations (continued)

FSB	Financial Stability Board
GAAP	Generally Accepted Accounting Principles
GFS	Government Finance Statistics
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
ICAA	The Institute of Chartered Accountants in Australia
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IIRC	International Integrated Reporting Committee
IPA	Institute of Public Accountants (formerly National Institute of Accountants)
IPSAS	International Public Sector Accounting Standard
IPSASB	International Public Sector Accounting Standards Board
MOU	Memorandum of Understanding
NZASB	Accounting Standards Board (of New Zealand)
NZAuASB	Auditing and Assurance Standards Board (of New Zealand)
NZICA	New Zealand Institute of Chartered Accountants
PCAOB	Public Company Accounting Oversight Board (of the USA)
PPC	Public Practice Certificate
PPQA	Public Practice Quality Assurance Review
PSB	Professional Standards Board (of New Zealand)
QA	Quality Assurance
RCA	Registered Company Auditor

Abbreviations (continued)

RDR	Reduced Disclosure Regime
SMEs	Small and medium-sized entities
SMSF	Self-Managed Superannuation Fund
TTAASAG	Trans-Tasman Accounting and Auditing Standards Advisory Group
Treasury	Australian Treasury
UK	United Kingdom
USA	United States of America
XRB	External Reporting Board (of New Zealand)

