

FRC Statement on Audit Quality

Given the importance of Australian audit quality in maintaining confidence in Australian capital markets, both the FRC and the Australian Securities and Investment Commission (ASIC) consider the results of the ASIC Audit Inspection Programs in 2017 and 2019 indicate further work and, in some cases, new or revised strategies are needed to improve audit quality.

After the 2017 ASIC findings and discussion with the former Minister for Revenue and Financial Services, the FRC concluded that it was premature to propose any legislative changes but that it would continue to monitor closely actions being taken and results achieved over the next year.

Subsequently, the FRC Chair met with the Chair and CEO of each of the four largest accounting firms and the CEO of each of the professional accounting bodies to seek their observations on audit quality and their proposed action. Those organisations sent formal written replies following the meetings.

To obtain a broader perspective on audit quality, the Chair also wrote to stakeholder groups interested in financial reports to seek their views. Formal written replies were received from ACNC, ACSI, AICD, APRA, ASA, ASFA, ASX, IIA and the Group of 100.

The FRC noted ASIC's findings from its financial reporting surveillance program consistently indicate that 4% of reports reviewed result in a material misstatement that requires correction.

The FRC considered the feedback and concluded that, based on the evidence, and while improvements are needed, external audits continue to assist in maintaining trust and confidence in financial reports.

Commentary suggesting this statement indicates that the FRC has a contrary view to ASIC regarding audit quality misrepresents the facts.

The FRC's statement focuses on whether the audit quality issues noted by ASIC appear to have had an impact on the desired outcomes of maintaining trust and confidence in financial statements. The FRC explicitly acknowledged in its February 2018 FRC Audit Quality Action Plan that, audit quality does need to improve.

The FRC Audit Quality Action Plan aims to achieve the following objectives:

- engage with users of financial reports to better understand their views on audit quality;
- undertake appropriate actions on the learnings of the ASIC Audit Inspection Program to contribute to the continuous development of best practice programs to assess audit quality; and
- engage with professional accounting bodies, firms providing audit services, and other stakeholders to support initiatives that improve audit quality.

Substantial progress on completing the Action Plan was made during 2018, with detail available on the FRC website and in the FRC Annual Report for 2017-18. The FRC continues to view collective action by all stakeholders in the financial reporting system as key to improving audit quality.

These views have been presented by the FRC to the Parliamentary Joint Committee on Corporations and Financial Services (PJC).

The FRC supports ASIC working on a response to the recent recommendation of the PJC that ASIC devise and conduct, alongside or within the current ASIC Audit Inspection Program, a study which will generate results which are comparable over time to reflect changes in audit quality. This is particularly important as there is no clear measure of 'audit quality' although there are many Audit Quality Indicators.

The FRC has conducted a review of professional and academic literature internationally which identified a range of Audit Quality Indicators (over 30) with varying degrees of measurability.

With the support of the FRC, the Auditing and Assurance Standards Board (AUASB) and ASIC have met and are working through areas where more guidance may be required in the auditing standards. The AUASB also meets with each of the Big 6 accounting firms to understand areas where they consider more guidance may be required. The AASB has also identified impairment issues as a key component of audit quality issues and its recent research report is being used to encourage the International Accounting Standards Board to improve the relevant accounting standard.

Two key initiatives undertaken by the FRC, in conjunction with the AUASB, include:

- a survey of Audit Committee Chairs (ACCs) - 91 responses from ACCs of the ASX top 300 companies revealed that 92% responded that they believed that audit quality was 'above average' or 'excellent'. This survey was conducted with the cooperation of ASIC; and
- a survey of professional investors - 47 responses from portfolio/investment managers, research analysts and other shareholders revealed that 60 per cent considered that audit quality was 'above average' - however 33 per cent considered audit quality was 'average' and this indicates that further action is required. This survey was conducted with the cooperation of FSC, ACSI, AIST, APRA and the Corporate Reporting Users Forum (CRUF).

In January 2019 ASIC released the results of its Audit Inspection Program results for the 18 months to 30 June 2018.

The FRC agree with the comments in ASIC's press release that although there were some improvements in findings collectively for the largest 6 firms, the overall findings suggest that further work, and in some cases, new or revised strategies, are still needed to improve audit quality.

The FRC recognises the response of the large accounting firms in Australia throughout 2018 to the concerns over audit quality. These firms have informed the FRC that they are implementing additional accountability mechanisms, expanding their communication and education, and conducting analysis of the root causes of any weaknesses identified by the ASIC reviews. The FRC will continue to monitor the outcomes of this work and its impact on audit quality.

The FRC continues to encourage all stakeholders in the financial reporting system to share their views and actions taken to address the issue of audit quality. The FRC will continue to implement its Audit Quality Action Plan, and to maintain continual dialogue and cooperation with stakeholders, particularly with ASIC, the AUASB and AASB to improve audit quality in the Australian financial system.