



# FRC AUDIT QUALITY ACTION PLAN

March 2023

## **Objective: Identify initiatives to support improvement in audit quality in Australia.**

In 2018 the FRC developed an Audit Quality Action Plan. It is a document that is continuously revised. Refer to Appendix 1 for actions completed to date.

### **1. Identify initiatives to respond to ASIC's Audit Inspection Findings**

Continue discussions with ASIC and audit firms to identify where guidance or amendments to standards will assist in reducing findings.

### **2. Implement the recommendations of the PJC Inquiry into Regulation of Auditing**

Continue to work with responsible standard-setting and regulatory bodies to implement the recommendations, particularly those specifically applicable to the FRC, AASB and AUASB. The Australian government is yet to respond to the report however planning for implementation of some recommendations is already in progress. Refer to Appendix 2 for the recommendations and the status of actions.

*Specific actions:*

- Reconvene the FRC PJC Inquiry Working Group meetings once a government response has been issued.
- Monitor IAASB's projects on going concern and fraud and continue to consider if other actions are required in Australia.

### **3. Work with ASIC, Accounting Firms and Professional Bodies to define and report on Audit Quality Indicators (AQIs)**

- Work with ASIC and the larger accounting firms to obtain consensus on what AQI will be reported and by whom. Options for reporting AQIs are by ASIC, the FRC, the AUASB or by the firms in their Transparency Reports.
- Determine how reporting of AQIs can assist communication of how audit quality is monitored and managed.

### **4. Obtain views of users of audit services on audit quality**

Commissioned independent research to gather perspectives on audit quality from a sample of ACCs. Report issued December 2022. ACCs remain very satisfied with the quality of their external auditor. Further communications and analysis of results to be conducted.

*Specific actions:*

- Similar research to be conducted bi-annually.
- Consider if there is value in conducting a research project to gather perspectives of investors on audit quality.

**5. Review the system of supporting and monitoring audit quality in Australia including the adequacy of repercussions for auditors of poor audit quality**

Building on the auditor disciplinary review conducted in 2019, review how audit quality is supported and monitored in Australia holistically and evaluate if any improvements are necessary. The following parties with roles and responsibilities relevant to supporting and monitoring audit quality, are in scope for this review:

- Audit firms
- Professional bodies
- ASIC
- AUASB
- Companies Audit Disciplinary Board (CADB)
- Accounting Professional & Ethics Standards Board (APESB)

**6. Engage with professional accounting bodies, firms providing audit services, and other stakeholders to support new initiatives that improve audit quality**

- Work with ASIC, Professional bodies, Australian Institute of Company Directors (AICD) and others on future initiatives to promote audit quality.
- Continue to monitor developments in the UK and the UK government's response to the report of the CMA, the Kingman Report and the Brydon Report.

**7. As we prepare for sustainability reporting including climate-related financial disclosures, engage with relevant stakeholders including regulators, preparers, professional bodies and assurance providers, in relation to measures required to support high quality assurance**

## APPENDIX 1

### ACTIONS COMPLETED TO DATE

#### 1. Identify initiatives to respond to ASIC's Inspection Findings

- Revised GS 005 *Evaluating the Appropriateness of a Management's Expert's Work* issued.
- Revised ASA 540 *Auditing Accounting Estimates and Related Disclosures* has been released and is now effective. Implementation support has been released.
- Revised ASA 315 *Identifying and Assessing the Risks of Material Misstatement* to require a more robust risk assessment process released. Implementation support has been released.
- Revised Quality Management Standards (QMS) have been issued and are effective 31 December 2022. Implementation support has been released.
- ASIC have raised substantive testing methods (sampling and substantive analytical procedures) as possibilities of standards to revise. These topics will be included in the AUASB's response to the IAASB's Proposed Strategy and Work Plan for 2024 – 2027.
- ASIC continually benchmark and review its Audit Inspection Program with the programs conducted by other regulators.
- AUASB Bulletins issued:
  - Integrity of Data Obtained for the Purpose of an Audit of a Financial Report September 2021
  - Supporting auditors in enhancing audit quality December 2021, and December 2022
  - Auditor's considerations in times of changing and uncertain economic conditions June 2022
  - ASA 315 and the Auditor's Responsibilities for General IT Controls June 2022
  - Evaluating the Reliability of Data obtained for Use in Audit Technology Tools November 2022

#### 2. Implement the recommendations of the PJC Inquiry into Regulation of Auditing

- Since the interim and final report were issued in 2020 the FRC PJC Inquiry Working Group consisting of representatives from the FRC, AUASB, AASB, APESB, and ASIC have been meeting to plan how to implement the recommendations in a co-ordinated manner. This group has implemented the recommendations considered appropriate however will wait for a final response before actioning them all. Refer to Appendix 2 for more detail.

#### 3. Work with ASIC, Accounting Firms and Professional Bodies to define and report on Audit Quality Indicators

- ASIC have reported some AQIs in Report 649 (2019) and 678 (2020) Audit Quality Measures, Indicators and Other Information which accompanied their report on the annual Audit Inspection Program. ASIC have not issued this report in 2021 and 2022 due to concerns that this report was not widely read and was time consuming to produce.
- A review of professional and academic literature was conducted by the FRC in 2018 which identified a range of AQIs (over 30), with various degrees of measurability. A summary of the literature was prepared and analysed by the FRC.

#### 4. Obtain views of users of audit services on audit quality

##### Audit Committee Chairs

- A survey conducted in 2018 and repeated in 2021, which was a joint initiative of the FRC and the AUASB. Overall, the results indicate that ACCs are very satisfied with the quality of their auditors (in the 2021 survey 94% considered their external auditor to be ‘above average’ or ‘excellent’ and was 92% in 2018).
- The reports are available on the FRC and AUASB websites and the results were included in ASIC’s Report 649 (2019) and 678 (2020) *Audit Quality Measures, Indicators and Other Information*.

##### Investors

- The FRC and the AUASB conducted a survey of Professional Investors in late 2018 with the assistance of FSC, ACSI, AIST, APRA and CRUF (Corporate Reporting Users Forum) for its distribution to investors. The survey was a replication of a survey conducted by the CFA Institute (a global association of investment professionals). There were 47 responses and final report was distributed in April 2019. Overall, the results revealed that 60 per cent considered that audit quality was above average – however 33 per cent considered that audit quality was average. The full report *Audit Quality in Australia: The Perspectives of Professional Investors* is available on the FRC and AUASB websites.
- The results of FRC and AUASB’s survey were included in ASIC’s Report 649 *Audit quality measures, indicators and other information*.
- This survey was repeated in 2021 however the response rate was too low to provide meaningful information.
- CA ANZ issued *Investor Confidence Survey Report* in 2020, 2021 and 2022 which captured the views of approximately a thousand retail investors in Australia. Results for 2022 consistent with prior years and showed that:
  - 87% per cent (91% 2021, 87 per cent 2022) of retail investors have confidence in the audited financial reports produced by Australian public companies
  - For the third year in a row auditors remain the most trusted group in advancing investor protection.

##### Chief Financial Officers

- A survey was conducted in September 2019 with the assistance of the Group of 100, to CFOs of the ASX top 300 companies.
- The survey response was disappointingly low at 27 responses. Of those, 25 of the 27 responded that their external auditor was ‘above average’ or ‘excellent’. The survey results did not raise any significant concerns over audit quality.

## **5. To review the adequacy of repercussions for auditors of poor audit quality**

Adequacy of auditor disciplinary functions were reviewed at the request of the government. The FRC's review was conducted over a period of four months, using evidence provided by the Australian Securities and Investments Commission (ASIC), the Companies Auditors Disciplinary Board (CADB), Chartered Accountants Australia and New Zealand (CA ANZ), CPA Australia and the Institute of Public Accountants (IPA). The FRC's report Auditor Disciplinary Processes: Review was presented to the Government in March 2019. It included 18 recommendations relating to:

- ASIC detection, investigation and enforcement processes, including that ASIC outline how their 'why not litigate' enforcement strategy will apply to misconduct by Registered Company Auditors (RCAs);
- CADB processes, including adopting a less formal and more timely approach to the carriage of CADB matters;
- ASIC's Audit Inspection Program, including publishing the results of audit inspections in greater detail, in particular naming firms, and for ASIC to be given the power to compel remediation of defective audits; and
- Professional accounting bodies processes, including formalising processes for advising each other and the FRC of their disciplinary proceedings.

In its response the Government agreed or supported all but one of the recommendations.

## **6. To engage with professional accounting bodies, firms providing audit services, and other stakeholders to support new initiatives that improve audit quality.**

- The accounting firms and professional bodies, collaborated and shared best practices for the benefit of the accounting profession and developed the following documents:
  - *An External Auditor's Guide to Improving Audit Quality Using Root Cause Analysis.*
  - *An External Auditor's Guide to Improving Audit Quality Using an Individual Recognition and Accountability Framework.*
- The accounting bodies conduct a wide range of education and communication initiatives and produce a variety of guidance materials related to audit quality. The FRC meets with the accounting bodies on a regular basis and is confident that they are demonstrating a clear commitment to improve audit quality.
- The International Organisation of Securities Commissions (IOSCO) issued in January 2019 its *IOSCO Report on Good Practices for Audit Committees Supporting Audit Quality*. This document complements the publication *Audit Committees – A Guide to Good Practice – 3rd edition* produced jointly by AUASB, AICD and IIA.
- To assist audit committees in fulfilling their responsibilities, the AICD and the AUASB have issued a new publication, *Periodic Comprehensive Review of External Auditor*, which provides guidance on a process and matters to consider when assessing their auditor.
- The FRC is also monitoring developments in the UK and are awaiting the UK government's response to the report of the CMA, the Kingman Report and the Brydon Report.

## APPENDIX 2

### PJC Inquiry into the Regulation of Auditing in Australia

	Recommendation	Status
1.	<p>The committee recommends that ASIC:</p> <ul style="list-style-type: none"> <li>- formally review the manner which it publicly reports the periodic findings of its audit inspection program, giving appropriate consideration to approaches used internationally; and</li> <li>- based on this review, develop and implement, by the end of the 2020–21 reporting period for its audit inspection program, a revised framework for reporting inspection findings, with a focus on the transparency and relative severity of identified audit deficiencies.</li> </ul>	<ul style="list-style-type: none"> <li>• Already in progress by ASIC prior to the PJC hearings and recommendations.</li> <li>• The final report of the PJC recognised that the transparency of individual firm findings had already been addressed.</li> <li>• ASIC is undertaking a ‘dry run’ of a severity rating system on audit files reviewed in the 12 months to 30 June 2022. ASIC will use the experience with the ‘dry run’ to consider any refinements of the model and make a decision whether to proceed with the model. If the model is adopted, severity ratings should be published in public audit inspection reports for the 12 months to 30 June 2023 with comparative information for the previous 12 month period.</li> </ul>
2.	<p>The committee recommends that the Australian Government introduce, by the end of the 2020–21 financial year, through appropriate legislation, a requirement that ASIC publish all future individual audit firm inspection reports on its website once ASIC has adopted a revised reporting framework referred to in Recommendation 1.</p>	<ul style="list-style-type: none"> <li>• Already in progress by ASIC independently of the PJC hearings and recommendations.</li> <li>• The final report of the PJC recognised that the transparency of individual firm findings had already been addressed.</li> <li>• ASIC published the individual audit firm inspection reports for the largest six firms for the 12 months ended 30 June 2020, 30 June 2021, and 30 June 2022. The firms published the reports for the period to 30 June 2019.</li> </ul>
3.	<p>The committee recommends that the Financial Reporting Council, in partnership with ASIC, by the end of the 2020–21 financial year, oversee consultation, development and introduction under Australian standards of:</p> <ul style="list-style-type: none"> <li>- defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and</li> <li>- a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.</li> </ul>	<ul style="list-style-type: none"> <li>• Fee disclosures are a requirement of the Australian Accounting Standards. The AASB has commenced preparatory work however will not propose amendments ahead of a government response. As part of this work the AASB has issued a Research Report examining fee disclosure requirements in other jurisdictions, and the APESB has issued an exposure draft with proposed categories.</li> <li>• Prohibitions on non-audit services are set by the APESB who have issued amendments made to the APES 110 Code of Ethics for Professional Accountants (including Independence Standards) to align with the International Code by the International Ethics Standards Board for Accountants revisions to the IESBA Code.</li> </ul>

4.	The committee recommends that the <i>Corporations Act 2001</i> be amended so that an auditor's independence declaration is expanded to require the auditor to specifically confirm that no prohibited non-audit services have been provided.	<ul style="list-style-type: none"> <li>• This has not been commenced as the auditor's independence declaration is a requirement of the <i>Corporations Act 2001</i> and an amendment requires a legislative change by the Federal Government.</li> <li>• The following is relevant: <ul style="list-style-type: none"> <li>○ The auditor's independence declaration states whether the auditor is aware of any non-compliance with the independence requirements of the <i>Corporations Act 2001</i> and the requirements of the APESB. The APESB Code of Ethics includes provisions concerning non-audit services.</li> <li>○ The <i>Corporations Act 2001</i> also requires directors of listed entities to state in the director's report whether they are of the view that the provision for non-audit services has compromised the independence of the auditor.</li> <li>○ The auditor's report currently includes a statement that the auditor is in compliance with the independence requirements of the <i>Corporations Act 2001</i> and the ethical requirements of the APESB. The statement could be expanded to specifically confirm that that no prohibited non-audit services have been provided which would require an amendment to the Auditing Standards by the AUASB.</li> </ul> </li> </ul>
5.	The committee recommends that the Australian Professional and Ethical Standards Board consider revising the APES 110 Code of Ethics to include a safeguard that no audit partner can be incentivised, through remuneration advancement or any other means or practice, for selling non-audit services to an audited entity.	The APESB have amended APES 110 Code of Ethics to incorporate this recommendation.
6.	The committee recommends that the Financial Reporting Council, by the end of the 2020–21 financial year, oversee the revision and implementation of Australian standards to require audited entities to disclose auditor tenure in annual financial reports. Such disclosure should include both the length of tenure of the entity's external auditor, and of the lead audit partner.	<ul style="list-style-type: none"> <li>• ASIC, the AASB, AUASB and AICD have previously discussed: <ul style="list-style-type: none"> <li>• which entities should be required to disclose, and</li> <li>• where this disclosure should be reside ie. directors' report, financial statements or auditor's report.</li> </ul> </li> <li>• General consensus is if there were to be a disclosure requirement, it should be in the directors' report as this would complement</li> </ul>

		<p>other required disclosures relevant to auditor's independence (the auditor's independence declaration and other additional required disclosures for listed entities). The purpose of the disclosure would need to be considered by Treasury and Government and may require public consultation. It also is recognised that defining audit tenure may be difficult given mergers of audit firms, company restructuring, etc. Any change in requirements would require a legislative change to the <i>Corporations Act 2001</i>.</p> <ul style="list-style-type: none"> <li>• An alternative is to include a requirement in Accounting Standards.</li> </ul>
7.	<p>The committee recommends that the <i>Corporations Act 2001</i> be amended to implement a mandatory tendering regime such that entities required to have their financial reports audited under the Act must:</p> <ul style="list-style-type: none"> <li>• undertake a public tender process every ten years; or</li> <li>• if an entity elects not to undertake a public tender process, the entity must provide an explanation to shareholders in its annual report as to why this has not occurred.</li> </ul> <p>The committee further recommends that such a tender process be implemented by 2022 for any entity that has had the same auditor for a continuous period of ten years since 2012.</p>	<p>Any changes would require an amendment to the <i>Corporations Act 2001</i> by the Federal Government. Public consultation by Treasury would be involved. This recommendation would potentially result in considerable costs to audited entities and auditors, and preparatory work has not commenced ahead of a Government response.</p>
8.	<p>The committee recommends that the Financial Reporting Council oversee a formal review, to report by the end of the 2020–21 financial year, of the sufficiency and effectiveness of reporting requirements under the Australian standards in relation to:</p> <ul style="list-style-type: none"> <li>- the prevention and detection of fraud; and</li> <li>- management's assessment of going concern.</li> </ul>	<ul style="list-style-type: none"> <li>• Preparatory work has commenced by the FRC, AASB and AUASB while waiting for a government response. Australia aims to ensure compliance with international accounting and auditing standards and the AASB and AUASB will monitor the international developments and timeline.</li> <li>• The International Auditing and Assurance Standards Board are currently revising ISA 570 <i>Going Concern</i> and it is expected an exposure draft will be issued in Australia in April 2023, and a final amended standard in 2024.</li> <li>• In addition, in Australia the following has been done: <ul style="list-style-type: none"> <li>○ The AASB and AUASB issued guidance <i>The Impact of COVID-19 on Going Concern and Related Assessments</i> for directors, preparers,</li> </ul> </li> </ul>



		<p>and auditors of financial statements of their existing responsibilities for going concern</p> <ul style="list-style-type: none"> <li>○ The AUASB conducted considerable outreach when responding to the <i>IAASB Discussion paper Fraud and Going Concern in an Audit of Financial Statements</i></li> <li>○ The AASB issued <i>Staff Paper: Going Concern Disclosures: A Case for International Standard-Setting to the IAASB</i></li> </ul>
9.	<p>The committee recommends that the <i>Corporations Act 2001</i> be amended such that entities required to have their financial reports audited under the Act must establish and maintain an internal controls framework for financial reporting. In addition, such amendments should require that:</p> <ul style="list-style-type: none"> <li>- management evaluate and annually report on the effectiveness of the entity's internal control framework; and</li> <li>- the external auditor report on management's assessment of the entity's internal control framework.</li> </ul>	<ul style="list-style-type: none"> <li>● Any change would require an amendment to the <i>Corporations Act 2001</i> by the Federal Government. Public consultation by Treasury would be involved. This recommendation would potentially result in considerable costs to audited entities, and preparatory work has not commenced ahead of a Government response.</li> <li>● If the Federal Government were supportive of this recommendation further work is required to consider which entities are in scope as the current recommendation “for entities required to have their financial reports audited under the Act” is too wide considering the costs of such reporting compared to expected benefits. This may require detailed analysis of international experience ie. United States.</li> </ul>
10.	<p>The committee recommends that the Australian Government take appropriate action to make digital financial reporting standard practice in Australia.</p>	<p>When operative, the legislation relating to the Australian Business Registry Service would allow the ABRS to require digital reporting. Digital reporting is unlikely to be pursued by ABRS given its other priorities. ASIC continues to maintain the reporting taxonomy and has accepted digital reports on a voluntary basis. ASIC continues to promote digital reporting, and the possible adoption of digital reporting of climate and sustainability information may be an impetus for digital financial reporting. The ISSB’s draft taxonomy will be exposed soon and is expected to adopt a similar architecture to the IFRS Taxonomy currently used by ASIC (with Australian extensions).</p>