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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services

By email: corporations.joint@aph.gov.au

13 September 2023

Dear Secretary

ASIC submission to the inquiry into Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry

We refer to your email to ASIC Chair Longo dated 18 July 2023 inviting ASIC to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into recent allegations of and responses to misconduct in the Australian operations of the major accounting, audit and consulting firms.

We also refer to the Government's plan to consult on reforms to strengthen regulatory arrangements for tax advisers, announced on 6 August 2023 and recent commentary on ASIC's audit surveillance program.

Summary

Major accounting, audit and consulting firms (**Firms**) primarily operate as partnerships with corporate structures within the Firm carrying out discrete parts of their operations. ASIC does not have general jurisdiction to regulate partnerships. It is only when the partnership performs certain specific roles, such as where the partnership holds an Australian Financial Services (**AFS**) licence, that ASIC has jurisdiction (in this example, over the entity's provision of financial services).

Our submission provides more detail on ASIC's jurisdiction, including over persons who perform roles within accounting, audit and consulting firms. We also explain ASIC's new approach to financial report and audit surveillance at the end of this submission.

Whether ASIC and other regulators' powers over accounting, audit and consulting firms are expanded is a complex matter for Government.

Global and national firm structures

Many accounting, audit and consulting firms (**Firms**) have complex structures involving partnerships. Partnerships are established in accordance with State or Territory laws.

Section 115(1) of the *Corporations Act 2001* imposes a limit on the members of a partnership. For accountants, the limit is 1000 members: regulation 2A.1.01 of the *Corporations Regulations 2001*. Historically the aim of limiting the size of partnerships was to prevent trading being carried out by large bodies in circumstances where those who deal with them would not know with whom they are contracting [1].

There are various ways that a Firm may involve more than 1000 members. For example, where membership of a partnership is held by joint trustees, there is only one member for the purposes of s115[2].

Governance and transparency

The Corporations Act does not impose obligations on partnerships in the way it imposes obligations on companies incorporated under the Act. For example, governance of a partnership is not subject to the type of duties the Corporations Act imposes on company directors. ASIC therefore does not have jurisdiction over the governance activity of partners in the way that we have jurisdiction over company directors.

Further, partnerships are not required to prepare financial reports or lodge information about their members with ASIC. As a result, ASIC has limited visibility over partnerships' financial position. Auditors and audit firms that conduct audits under the Corporations Act of 10 or more listed entities are required lodge a transparency report with ASIC[3]. The transparency report includes information about the Firm's audit operations and related quality management systems. It does not include information about a Firm's other non-audit operations and services provided to non-audit clients (such as consultancy services or tax).

Many Firms use company structures to conduct some of their activities, but this would usually involve a proprietary company rather than a public company. A small proprietary company is not generally required to prepare financial reports: s292(2) of the Corporations Act[4]. We estimate that the Big Four firms have registered a total of 148 Australian companies, the majority of which are proprietary companies[5].

All audit firms, including those which operate as partnerships, are subject to requirements for governance and corporate culture set out in Australian Auditing Standard ASQM 1: Quality Management for Firms that Perform Audits or Reviews of Financial Reports and Other Financial Information, or Other Assurances or Related Services Engagements. This is an auditing standard made by the Auditing and Assurance Standards Board. ASIC can only take action for non-compliance with an auditing standard, including poor governance or culture, in the context of a Firm's individual audit of another entity.

To support improved audit quality, over the past few years ASIC has reviewed the Big Four firms' quality management systems, focusing on various governance issues and published reports with better practice recommendations. For example, Report 677 *Audit inspection report: 1 July 2019 to 30 June 2020* at pages 17 -18, Report 709 *Audit inspection report: 1 July 2020 to 30 June 2021* at pages 19- 23 and Report 739 Root

[1] *Smith v Anderson* (1880) 15 Ch D 247 at 273 cited in Austin & Black, *Annotations to the Corporations Act*.
[2] *Smith v Anderson* (1880) 15 Ch D 247 at 273, ibid.
[3] Part 2M.4A of the Corporations Act.
[4] A large proprietary company is required to prepare audited financial statements and lodge them with ASIC. A proprietary company is large for a financial year if it satisfies two of the requirements in s45A (3) of the Corporations Act. For example, if consolidated revenue is $50 million or more or the value of consolidated gross assets is $25 million or more: s45A(3) and reg 1.0.02B, *Corporations Regulations 2001*.
[5] This estimate is based on search of companies registered with ASIC that appear to be associated with one of the Big Four firms based on the name of the company.

cause analysis: Audit firm thematic review.

Law reform would be required to give ASIC the power to take action on audit firm compliance with quality management standards such as ASQM 1.

ASIC's jurisdiction over the auditing and accounting professions

ASIC's recent submission of 23 June 2023 to the Senate Economics References Committee (**SERC**) inquiry into ASIC Investigation and Enforcement (**attached**) contains details on ASIC's jurisdiction over entities and individuals that have a role in the accounting and audit professions. ASIC also commented on regulation of the audit profession in our submission dated October 2019 to the PJC Inquiry into the Regulation of Auditing.

In summary, ASIC does not have general jurisdiction over Firms that are partnerships. ASIC has some jurisdiction over entities or individuals who are registered or licensed by ASIC to perform a particular role. Most larger Firms, including the Big Four, have a number of entities or individuals who are registered or licensed by ASIC to perform roles within the accounting, audit and consulting professions.

By way of example, ASIC has some jurisdiction over:

- companies that are registered by ASIC as Authorised Audit Companies – as at 30 June there were 208 audit companies registered by ASIC (none of the Big Four firms have registered as an Authorised Audit Company).
- entities that hold an AFS licence and authorised representatives of AFS licensees.
- Registered Company auditors – as at 30 June 2023, there were 3,082 company auditors registered by ASIC.
- SMSF Auditors – as at 30 June 2023, there were 4,423 SMSF auditors registered by ASIC
- Registered Liquidators – as at 30 June 2023, there were 654 Registered Liquidators.

ASIC can take action against these entities and individuals in circumstances where they have contravened specific provisions in laws administered by ASIC in the performance of their functions and duties.

For example, entities that hold an AFS licence are required to adhere to general obligations in the provision of financial services. These obligations include a requirement to ensure that the licensee has in place adequate arrangements for the management of conflicts of interest that might arise in relation to the provision of financial services by the licensee or its representatives. ASIC can take action where an AFS licensee has failed to meet its AFS license obligations in the provision of financial services.

Role of Big Four firms

The Big Four firms dominate the auditing of larger ASX listed companies. Table 1 shows the number of ASX listed companies audited by the Australian operations of the Big Four firms and the listed companies' market capitalisation (by value and percentage) as at 31 December 2022. We estimate that the Big Four audit approximately 33% of ASX companies, representing 95% of ASX companies by market capitalisation.

Table 1

Audit firm	Number of audits	% of total ASX listed companies	Market capitalisation of audited companies $	% of total market capitalisation
Deloitte (Australia)	127	6.68	176,205,802,290	7.73
EY (Australia)	194	10.21	837,559,761,163	36.73
KPMG (Australia)	150	7.89	354,125,516,050	15.53
PwC (Australia)	145	7.63	782,401,178,459	34.31
Other firms	1,284	67.58	129,870,190,663	5.70
Total	1900	100	2,280,162,448,625	100

Source: ASIC calculation from ASX data at 31 December 2022

Table 2 shows the number of open insolvency appointments at the Big Four firms and the number of registered liquidators at those firms.

Table 2

Audit firm	Open insolvency appointments	% of total open insolvency appointments	Registered liquidators	% of Registered liquidators
Deloitte (Australia)	384	2.20	25	3.82
EY (Australia)	115	0.66	14	2.14
KPMG (Australia)	378	2.17	24	3.67
PwC (Australia)	400	2.29	16	2.45
Other firms	16,168	92.68	575	87.92
Total	17,445	100	654	100

Source: ASIC data as at 30 June 2023

Ethical codes and disciplinary bodies

Individual partners of Firms and employees may be subject to ethical codes and standards overseen by their relevant professional disciplinary bodies. For example, tax agents are registered and monitored by the Tax Practitioners Board. Other disciplinary bodies in the auditing and accounting profession include: the CPA Australia Disciplinary Tribunal, the Chartered Accountants Australia and New Zealand Disciplinary Tribunal, and the Institute of Public Accountants Disciplinary Tribunal. The jurisdiction of these tribunals is limited to members of the relevant professional association.

ASIC is able to refer Registered Company Auditors to the Companies Auditors Disciplinary Board, Registered Liquidators to the Liquidators Disciplinary Committee, and financial advisers to the Financial Services and Credit Panel for disciplinary or other administrative action. These bodies are constituted under the ASIC Act or Corporations Act.

Regulation of auditing and accounting firms in other jurisdictions

Several international jurisdictions have increased regulation of auditing and accounting firms. For example, in March 2021 the UK Government began consultation on improving the UK's audit, corporate reporting and corporate governance systems (with the release of a whitepaper entitled "Restoring trust in audit and corporate governance"). Since then, the UK Government has proposed the establishment of an Audit, Reporting and Governance Authority (replacing and expanding on the role of the current UK regulator, the Financial Reporting Council), and has also recently announced an update to the UK Corporate Governance Code.

The USA has also previously taken action to address major failures in corporate accounting (following the collapse of Enron and WorldCom in the early 2000s), with US Congress enacting the Public Company Accounting Reform and Investor Protection Act of 2002 (the 'Sarbanes-Oxley Act') to improve auditing and public disclosure by audit firms. The Sarbanes-Oxley Act established the Public Company Accounting Oversight Board (**PCAOB**) and, relevantly, empowers it to conduct investigations and disciplinary proceedings concerning registered accounting firms (and associated persons) for violations of the law, including professional standards, and to take disciplinary action for those violations.

International regulators with the power to register audit firms have taken action for poor culture and governance. For example:

- The US Public Company Accounting Oversight Board (**PCAOB**) sanctioned KPMG Australia for cheating on mandated training by censuring it, imposing a US$450,000 civil penalty, and requiring KPMG to undertake certain remedial actions because KPMG violated PCAOB rules and quality control standards.
- The US Securities and Exchange Commission (SEC) fined EY US $US100 million ($144 million) after finding dozens of EY US audit personnel had cheated on the ethics portion of the US Certified Public Accountant exam and that the firm had misled regulators probing the conduct.
- The PCAOB fined PricewaterhouseCoopers LLP Canada US$750,000 ($900,000) for having faulty quality control standards that allowed more than 1,200 professionals to cheat on internal training courses.

ASIC is unable to take this kind of action on audit firms' poor culture and governance because, unlike the US, the Australian quality management standard is an auditing standard under the Corporations Act and ASIC can only act against a lead audit partner for non-compliance with an auditing standard in the conduct of an individual audit. Further, ASIC registers individuals as Registered Company Auditors (not audit firms) and ASIC has no ability to act against a Firm or staff of a firm who are not RCAs for misconduct related to culture and governance (such as training matters).

ASIC's approach to financial reporting and audit surveillance

There is no legislative requirement for ASIC to undertake proactive surveillance of financial reports and audits. However, ASIC has conducted financial report surveillances since 1991, and audit surveillances of the Big Six firms (including audit file reviews) from 2005. The objective of our surveillance is to promote confident and informed participation by investors and consumers in the financial system, through high-quality financial reports and audits.

Until 2022, ASIC's surveillance of financial reports and audit files was separate. However, after an internal strategic review, ASIC decided to adopt a risk based, targeted approach by combining our surveillance of financial reports and audit. This includes utilising greater intelligence capabilities to identify potentially deficient financial reports for review. After our review, we engage with the relevant company and if problems with the financial report are confirmed, we then conduct surveillance on the relevant company's audit. This is partly because we have found there is a strong link between problems in a financial report and the quality of audit work that was undertaken. ASIC informed stakeholders in the accounting and audit professions about our new approach in November 2022.

While this risk-based approach will result in a smaller number of audit files being reviewed by ASIC, it will ensure our focus is directed to those files where there is more likely to be harm to consumers and investors through deficient financial reports and may result in a larger proportion of matters being referred for enforcement action. A targeted approach also represents a more effective use of our resources, which have declined in real terms in recent years.

ASIC's proactive surveillance program meets the requirements and principles of the International Forum of Independent Audit Regulators, which includes regulators from the UK, Canada and the US.

ASIC will continue to carry out reviews of the Big Six firms' quality management systems on appropriate themes that are identified through our work relating to oversight of individual auditors. Report 739 *Root cause analysis: Audit firm thematic review* is an example of the type of review we will continue to conduct.

ASIC has made submissions to a previous parliamentary inquiry on reform that would significantly enhance the quality of financial reporting and its audits. This includes:

- requiring auditors to report on the accuracy of the company management assertion that internal accounting controls in place are operational and effective (similar to requirements under the Sarbanes-Oxley Act); and
- mandating digital financial reporting by listed companies and other entities preparing financial reports under the Corporations Act[6].

Transparency on ASIC's approach to financial reporting and audit surveillance

ASIC will continue to be transparent about our financial reporting and audit surveillance. This starts with informing stakeholders about potential problem areas that we will scrutinise in upcoming reporting periods. Our aim with putting stakeholders on notice is to proactively stop those problems from arising in financial reports. On 6 June 2023, ASIC released its focus areas for financial report preparers and auditors for the 30 June 2023 financial reports (see 23-149MR).

After our combined financial report and audit surveillance is complete, we will publish a report covering findings and outcomes. Our first report on combined surveillance of financial reporting and audit for 2022-23 is due to be published in late 2023. The combined surveillance report provides a comprehensive overview of the financial reporting chain and, in addition to auditors, will make other stakeholders, like financial report preparers and audit committees, more accountable for the quality of the financial report and audit execution.

To improve the effectiveness of our audit findings, we have started directly communicating negative audit findings to the directors of the audited entity in

[6] See ASIC's submission dated October 2019 to the PJC Inquiry into the Regulation of Auditing at paragraph 80.

accordance with Regulatory Guide 260 *Communicating findings from audit files to directors, audit committees or senior managers*. This enables constructive discussions between the company and their auditors to improve the quality of the financial report and audit.

We will also continue to publish media releases when a company restates its accounts or makes material changes following our surveillance.

Yours sincerely,

Greg Yanco
Executive Director
Regulation and Supervision

Australian Securities and Investments Commission investigation and enforcement
Submission 49

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23 June 2023

Dear Secretary

ASIC submission to the Inquiry into ASIC Investigation and Enforcement – enforcement of standards in the auditing and accounting profession and recent allegations involving PwC

We refer to your letter to ASIC Chair Longo dated 19 May 2023, inviting ASIC to make a submission on
the matter of how governance laws and standards are enforced in the auditing and accounting professions and the role of ASIC in relation to recent breach of confidence allegations involving PricewaterhouseCoopers (**PwC**) and a number of its partners, including Mr Peter-John Collins.

ASIC considers the alleged conduct of Mr Collins and PwC to be a serious breach of trust, and notes referral of these issues to the Australian Federal Police.

ASIC is currently taking a number of steps to ascertain whether the conduct of any involved individuals enlivens ASIC's jurisdiction, including seeking information about those individuals to understand to what extent they hold professional registrations administered by ASIC. On receipt of that information we will determine whether investigation by ASIC is warranted in the circumstances.

ASIC's submission is set out below.

ASIC has no jurisdiction over the governance activity of partners of the big four consultancy firms

PwC Australia is a partnership established in accordance with the laws of the Australian Capital Territory (pursuant to the *Partnership Act 1963*), offering a broad range of services. ASIC's jurisdiction in relation to the auditing and accounting profession does not extend to the governance activity of partners of the big four consultancy firms, as the duties that the partners owe to partnerships (such as those that directors owe to companies) are not governed by the Corporations Act or the ASIC Act.

As individuals, partners may be subject to separate disciplinary, civil or criminal sanctions under legislation or codes that are not administered by ASIC.

Professional disciplinary bodies are responsible for breaches of codes of ethics by professionals involved in the audit and accounting industry

The auditing and accounting profession comprises a range of professionals. These professionals are generally subject to certain ethical codes and standards overseen by their relevant professional disciplinary bodies.

Tax agents are registered and monitored by the Tax Practitioners Board. Other disciplinary bodies in the auditing and accounting profession include: the CPA Australia Disciplinary Tribunal, the Chartered Accountants Australia and New Zealand Disciplinary Tribunal, and the Institute of Public Accountants Disciplinary Tribunal. The jurisdiction of these tribunals is limited to members of the relevant professional association.

ASIC's jurisdiction in relation to the auditing and accounting professions arises in certain specific circumstances

ASIC supervises companies that are registered by ASIC as Authorised Audit Companies, or entities that hold an Australian Financial Services (**AFS**) licence.

ASIC also supervises individuals who are registered by ASIC as Registered Company Auditors (**RCA**), SMSF Auditors (**SMSFA**), or Registered Liquidators (**RL**); AFS licensees and their authorised representatives; or individuals who are directors, officers or employees of companies.

ASIC can take criminal or civil action against the companies, entities, and individuals outlined above in circumstances where they have contravened specific provisions in the Corporations Act, the ASIC Act or the Superannuation Industry (Supervision) Act (or in other laws administered by ASIC) in the performance of their functions and duties. ASIC can also, in certain instances, take administrative or disciplinary action against these companies, entities and individuals.

ASIC is also able to refer RCAs to the Companies Auditors Disciplinary Board, RLs to the Liquidators Disciplinary Committee, and financial advisers to the Financial Services and Credit Panel for disciplinary or other administrative action. These bodies are constituted under the ASIC Act or Corporations Act.

ASIC's jurisdiction over companies and partnerships that are Authorised Audit Companies, Audit Firms and Australian Financial Services licensees

ASIC regulates Authorised Audit Companies (**AAC**) under the Corporations Act for compliance with auditing standards and other legislated audit requirements. The AAC registration is limited to companies, and therefore the PwC partnership is not registered as an AAC. ASIC records indicate that there are no PwC incorporated entities that are AAC's.

Although a partnership can be appointed to act as an auditor for a company, registered scheme or to an AFS licensee that is not a public company (an '**Audit Firm**'), that appointment is taken to apply only to members of the firm who are, at the date of appointment, RCAs; it does not extend to the partnership more generally.

Further, while ASIC regulates Audit Firm compliance with the auditing standards (including the auditing standard requirements around governance and firm culture), ASIC is only able to take action against an individual who is an RCA of an Audit Firm in the circumstances outlined in the following section.

ASIC also regulates entities, including companies and partnerships, that hold an AFS licence. AFS licensees are required to adhere to certain general obligations in the provision of financial services. These obligations include a requirement to ensure that the licensee has in place adequate arrangements for the management of conflicts of interest that might arise in relation to the provision of financial services by the licensee or its representatives. ASIC is able to take a broad range of action in circumstances where an AFS licensee has failed to meet its AFS license obligations in the provision of services.

PwC's investment management company, PricewaterhouseCoopers Securities Limited (ACN 003 311 617)(**PwC Securities**), holds an AFS licence. There is currently no information to indicate that the alleged misconduct occurred in connection with the provision of financial services.

ASIC's jurisdiction over individuals who are registered company auditors, SMSF auditors, registered liquidators, AFS licensees, authorised representatives, and financial advisers

In certain circumstances, the conduct of individuals may be subject to ASIC's jurisdiction, such as where those individuals also hold the role of RCA, SMSFA, RL, or where they are an AFS licensee, an authorised representative of an AFS licensee, or financial adviser. ASIC's oversight of these individuals relates to their compliance with relevant legislative requirements whilst performing their function or duty. For example, ASIC's oversight of RCAs and SMSFAs relates to their adherence to legislative requirements during the course of an audit activity, and its oversight of financial advisers relates to their provision of financial services. In some instances, ASIC is able to take criminal or civil action in relation to non-compliance with these legislative provisions.

ASIC has jurisdiction to disqualify individuals who are registered as SMSFAs, or to cancel or impose additional conditions on their registration. Where an individual has been registered with ASIC as an RCA or RL, ASIC is also able (in limited circumstances) to take action to suspend or cancel that individual's registration, and may also refer that individual to the CADB or LDC as appropriate. Possible grounds for disciplinary action by one of these disciplinary bodies include that the individual is no longer a fit and proper person to remain registered. Disciplinary action can only be taken by ASIC, the CADB or the LDC against individuals who are *currently* registered as an SMSFA, RCA or RL.

ASIC is also able to take similar action to ban individuals who are AFS licensees, or the authorised representatives of AFS licensees, from providing financial services or from carrying on a financial services business, on the grounds that they are no longer a fit and proper person to provide financial services. Authorised representatives who are financial advisers and planners are also subject to additional accountability and education requirements, including an obligation to adhere to the *Financial Planners and Advisers Code of Ethics 2019*.

Mr Peter-John Collins is not a RCA, SMSFA, or RL; however, he was an authorised representative of AFS licensee PwC Securities between 1 March 2004 and 14 July 2006, and 9 December 2013 and 6 October 2022. ASIC has been provided with information regarding Mr Collins' role in the alleged misconduct and is assessing whether there are sufficient grounds to take regulatory action to prevent Mr Collins from providing financial services in the future.

ASIC has also sought information in relation to other individuals involved in the alleged conduct to understand to what extent they hold professional registrations administered by ASIC.

ASIC's jurisdiction over directors and officers of corporations

ASIC also has jurisdiction to regulate the conduct of individuals within the auditing and accounting profession in circumstances where those individuals hold the role of director or officer of a corporation.

The Corporations Act imposes a number of duties on corporate directors and officers These duties are owed to the company, and include the requirement to exercise powers and discharge duties with due care and diligence; and with good faith, for a proper purpose, and in the best interests of the corporation. Moreover, directors and officers of companies must not improperly use their position, or use information obtained as a result of their corporate position, to gain an advantage for themselves or someone else to the detriment of the corporation.

ASIC has not received information that indicates that the alleged misconduct occurred in connection with the management of a corporation.

Approach to culture of auditing and accounting firms in other jurisdictions

A number of international jurisdictions have moved to increase regulation in relation to auditing and accounting firms.

For example, in March 2021 the UK Government began consultation on improving the UK's audit, corporate reporting and corporate governance systems (with the release of a whitepaper entitled "*Restoring trust in audit and corporate governance*"). Since then, the UK Government has proposed the establishment of an Audit, Reporting and Governance Authority (replacing and expanding on the role of the current UK regulator, the Financial Reporting Council), and has also recently announced an update to the UK Corporate Governance Code.

The USA has also previously taken action to address major failures in corporate accounting (following the collapse of Enron and WorldCom in the early 2000s), with US Congress enacting the *Public Company Accounting Reform and Investor Protection Act of 2002* (the 'Sarbanes-Oxley Act') to improve auditing and public disclosure by audit firms. The Sarbanes-Oxley Act establishes the Public Company Accounting Oversight Board (PCAOB) and, relevantly, empowers it to conduct investigations and disciplinary proceedings concerning registered accounting firms (and associated persons) for violations of the law, including professional standards, and to take disciplinary action for those violations.

Yours sincerely,

Melissa Smith,
A/g Executive Director
Markets Enforcement