

PJC Inquiry into the regulation of auditing in Australia		
October 2022		
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Key Messages

We continually review our regulatory activities to ensure they are effective. We are implementing changes which will better align our financial reporting and auditor surveillance efforts from 2022-23.

A recommendation from the PJC's Inquiry into the Regulation of Auditing in Australia on greater transparency of ASIC's inspection results for individual firms has been addressed. Under a more focused risk-based approach to identifying audit files for review based on our financial report reviews and other intelligence from 2022-3, the number of audit files reviewed at each audit firm will not warrant individual firm inspection reports.

Consistent with another recommendation, ASIC has trialled a model for reporting on the relative severity of inspection findings. We are assessing the results and considering whether to implement the model.

Background – PJC Inquiry

Following a resolution in The Senate put forward by Senator Deborah O'Neill, the PJC undertook an Inquiry into the Regulation of Auditing in Australia in 2019 and 2020. An Interim Report was issued in February 2020 (see Regulation of Auditing in Australia: Interim Report (aph.gov.au)) and a final report in November 2020 (see Regulation of Auditing in Australia: Final Report). The ten recommendations in the Interim Report were repeated in the Final Report.

The Inquiry occurred in the background of high-profile corporate failures in the UK, media concerns about auditor conflicts of interest, and earlier comments by ASIC Chair Greg Medcraft on his departure from ASIC that audit quality was "appalling".

The previous Government had not responded to the PJC recommendations prior to the election. Treasury has indicated that a response may be made by the current Government. While Senator O'Neill (now PJC Chair) has called for the recommendations to be actioned, many require legislation after due consultation. Agencies would not normally act ahead of a government response.

Background – ASIC audit inspections

In our view, auditors did not obtain reasonable assurance that the financial reports were free from material misstatement in 36% of 146 key audit areas that ASIC reviewed across 45 audit files in the 12 months to 30 June 2022 (32% for the six largest firms) (Report 743 Audit inspection report: 1 July 2021 to 30 June 2022 - planned for release on 28 October 2022).

ASIC's future regulatory initiatives to improve audit quality will include:

- further enhancing our risk-based targeting and intelligence processes for identifying financial reports for review;
- financial report review outcomes and other intelligence inform which audit files we will review;
- routinely communicating audit file review findings to directors of audited entities from 1 July 2022;
- publishing one annual report on the outcomes from both our financial reporting and auditor surveillances, recognising the importance of the entire reporting chain to quality reporting; and
- continued enforcement actions for deficient audits, where appropriate.



Background – PJC recommendations

The first three of the recommendations from the PJC's Audit Inquiry are particularly relevant to ASIC:

Recommendation	Status
<p>1. ASIC formally review the manner which it publicly reports the periodic findings of its audit inspection program, giving appropriate consideration to approaches used internationally.</p> <p>Based on this review, ASIC 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.</p>	<p>ASIC regularly reviews reporting by other regulators and is consistent with best practice. ASIC's reporting of findings on key audit areas gives a better reflection of audit quality than the reporting on a file basis used by other regulators.</p> <p>ASIC is assessing experience from a 'dry run' of a severity rating system on audit files reviewed in the 12 months to 30 June 2022. ASIC is considering whether to refine the model and whether to proceed with the model. If the model is adopted, severity ratings would be published in reports for the 12 months to 30 June 2023 with comparative information.</p>
<p>2. 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>	<p>The PJC's final report recognised that ASIC was already publishing audit inspection reports on the largest six firms annually which addressed this recommendation.</p> <p>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. . Under the more focused risk-based approach to identifying audit files for review based on our financial report reviews and other intelligence from 2022-3, the number of audit files reviewed at each audit firm will not warrant individual firm inspection reports.</p>
<p>3. 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">▪ defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and▪ a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.	<p>Fee disclosures are a requirement of the Australian Accounting Standards. The Australian Accounting Standards Board (AASB) commenced preparatory work on however will not propose amendments ahead of a government response.</p> <p>At present, non-audit services are covered in the Accounting Professional & Ethical Standards Board (APESB) Code of Ethics. The Code has indirect force of law through the auditing standards. The APESB (a non-government body funded by the three largest accounting bodies) is consulting on whether to align to recent amendments made to the International Code by the International Ethics Standards Board for Accountants.</p>