

Financial Reporting Council

Annual Report 2010-11

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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

9 October 2011

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 2011.

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.

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 black ink 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.

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 (Attachment 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.

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 are preparing separate annual reports for the Minister concerning their operations during 2010-11.

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.

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 past year has seen a number of key developments in financial reporting, both domestically and internationally. Overseas the trend towards adoption of International Financial Reporting Standards (IFRS) is continuing, with more countries joining the IFRS community, especially in Asia-Oceania. Domestically a number of key topics are dominating the debate around financial reporting, including integrated reporting and audit quality.

Since taking over as FRC Chairman in March 2011, I have realised that the FRC has an important role to play in all of these areas. The subsequent pages of this annual report provide more detail about how we are striving to do this. I would at the outset like to highlight the efforts of my predecessor, Jeffrey Lucy AM, in positioning the FRC as a recognised and respected stakeholder in Australia and internationally in the field of financial reporting. Jeffrey in his two terms as FRC Chairman has had a key influence in shaping its profile and its activities. The plans for the FRC's future activities that are outlined in this annual report build on his achievements, and I would like to thank him here for his efforts over the five years he has devoted to the FRC.

FRC Strategic Plan 2011-2014

My first priority after taking over as Chairman was to work out and agree with the Members of the FRC a strategic plan covering the three years of my term, based on strategic discussions that had already taken place at meetings. I am happy to say that we achieved this very quickly, and that the FRC, at its meeting of 18 April 2011, approved in principle the Strategic Plan 2011-2014 which is described in more detail later on in this report.

The strategic plan is an important document which starts with an analysis of the FRC's functions and the environment in which it is operating. It then develops the analysis to arrive at a number of priority projects which will form the focus of the FRC's activities over the next period. I am pleased to report that work on these projects has already started, and that the initial indications are very promising. I expect that the results produced by the FRC Members working on these projects, partly in cooperation with representatives of the wider financial reporting community, will be valuable and make

an important contribution to improving the FRC's relevance and position in Australia and overseas.

Oversight of standards setting

The key theme dominating international developments continues to be the effort to create a single set of global high-quality accounting standards, and the IFRS issued by the International Accounting Standards Board (IASB) in London continue to represent our best hope for achieving this objective. The FRC, and the AASB, fully support this effort and the work of the IFRS Foundation, both through the financial contribution made by the FRC on behalf of the Australian Government to the Foundation and through the in-kind contribution made by the AASB to the work of the IASB.

Over the past year there has been considerable debate about the governance of the IFRS Foundation, with both the IFRS Foundation's Trustees and the Monitoring Board conducting reviews and asking for submissions. The FRC responded to all of these requests, after giving extensive consideration to the key issues raised in the reviews.

A key focus for the FRC is to foster and support regional adoption of IFRS. In this respect the FRC was very active during the year, and worked with counterparts from across Asia-Oceania in encouraging the adoption of IFRS by regional jurisdictions.

Our links with New Zealand have continued to strengthen on all levels over the past year, and I expect that this cooperation will continue with the establishment of new institutional arrangements for standard setting in New Zealand on 1 July 2011.

On the domestic front the FRC continued to monitor developments related to audit independence, and in particular followed the work done by Treasury subsequent to the release of the Audit Quality Review in 2010. I expect that this matter will continue to be of particular importance to the FRC, especially as its role in relation to audit independence is under review by the Government.

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, growing international pressure for greater regulation of auditors.

During 2010-11 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 overall conclusion reached by the FRC as a result of its 2010-11 work on auditor independence is that the independence framework in Australia continues to operate effectively.

Outlook for 2011-12

2011-12 will be a crucial year in which a number of key decisions will be made in relation to the global adoption of a single set of accounting standards. In particular, a decision in principle is expected from the Securities and Exchange Commission (SEC) of the United States of America (USA) as to whether adoption of IFRS in that jurisdiction will be prescribed. The decision by the SEC is expected to have a key impact on a number of other important jurisdictions, in particular Japan. I am planning to visit a number of the key stakeholders involved in these decisions later in 2011 to understand their views and offer the FRC's perspective on the issues involved.

A key objective for the FRC next year will be to start delivering outputs from its priority projects. I know that the FRC Members have started work on the issues involved in these projects, which are all matters that are of substantial interest and concern to the financial reporting community in Australia. A key issue on the horizon is integrated reporting which has been identified as a possible means of providing more holistic information about an entity's operations rather than the perceived narrow focus of financial reporting. I expect that the FRC will be devoting significant time and resources to exploring this and the other matters addressed in the projects.

Acknowledgements

In addition to thanking Jeffrey Lucy, I would also like to acknowledge the contributions of all FRC Members for the generous assistance they have provided. I would also like to welcome Kevin Lewis, Vas Kolesnikoff and Grant Hehir who joined the FRC during the year.

Don Challen (who was one of the FRC's founding members), John Gethin-Jones, Eric Mayne and Stuart Wilson left the FRC during the year. I would like to thank them for their contributions and wish them well for the future.

The FRC Secretariat provides invaluable services that ensure the smooth operation of the FRC. On behalf of the FRC as a whole, I would like to thank the Secretary, Michael Lim, and the other members of the Treasury team working on FRC matters for their efforts.

I have greatly enjoyed my first months as FRC Chairman. I look forward to working with the FRC Members in the coming year to further improve the contribution of the FRC as a key part of the financial reporting community in Australia and overseas.

A handwritten signature in black ink, reading "Lynn Wood". The signature is written in a cursive style with a large initial 'L' and 'W'.

Lynn Wood
Chairman of the Financial Reporting Council
9 October 2011

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 FRC STRATEGIC PLAN 2011-2014

1.1 INTRODUCTION

During the year a new FRC Chairman, Lynn Wood, commenced her term on 11 March 2011. One of her initial actions was to initiate a strategic plan for the FRC covering the three years of her term from 2011 to 2014 based on ideas developed during the previous strategic discussions that had taken place on the FRC and Members' views expressed as part of the annual peer review process.

The plan reviews the main functions of the FRC, conducts a SWOT (strengths, weaknesses, opportunities and threats) analysis of the financial reporting framework in Australia, defines a range of strategic issues to be considered by the FRC, and concludes with an action plan for the FRC.

The FRC Strategic Plan 2011-2014 was approved in principle at the FRC meeting on 18 April 2011 and subsequently confirmed by Council members. The full text of the plan is available as Appendix A and on the FRC's website at www.frc.gov.au.

1.2 AUSTRALIA'S FINANCIAL REPORTING FRAMEWORK

The strategic plan concludes that the financial reporting framework in Australia is characterised by a number of key strengths, including its resilience during the global financial crisis, the assistance it is providing to Australian corporations in accessing global financial markets, and the leading role played by Australia (and New Zealand) in public sector financial reporting.

On the other hand, there are areas where the framework could potentially be improved, some of which at least partly reflect concerns in relation to IFRS, the global financial reporting standards adopted by Australia. These include the complexity and length of financial statements, their almost exclusive focus on financial reporting (neglecting to some extent the wider context in which companies and other entities operate), and a lack of focus on financial reporting for not-for-profit entities. A further area that could potentially be improved is the level of financial literacy among users, including company directors.

Opportunities arise from factors such as the growing political pressure, including from key international bodies such as the G20, for the introduction of global standards in financial reporting, and a growing interest around the world in the use of integrated reporting to provide more relevant information to users of financial statements.

Finally, the analysis showed that there were a number of ongoing and emerging issues that needed to be monitored, including overseas proposals to regulate audit practices, complexity caused by Australia's federal structure, and a plethora of proposals to impose additional reporting and disclosure requirements, for example as part of a Corporate Social Responsibility or Environmental, Social and Governance agenda without appropriate evaluation of cost benefit considerations.

Based on this analysis, the plan concludes that the FRC ought to be considering a number of key strategic issues, including 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 monitor the effectiveness of auditor independence and other audit quality drivers; and
- How best to meet the needs of users of profit-oriented and not-for-profit entities.

1.3 ACTION PLAN

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. These projects are grouped into two categories, the first being a number of priority projects in which the FRC proposes to take a leadership role, and the second being a number of projects in which the FRC will play a supporting role.

Further detailed information about the priority projects is provided in the next section. The group of remaining projects includes matters such as influencing adoption of IFRS in the region and globally, monitoring private-sector not-for-profit financial reporting developments and keeping in touch with as well as influencing international developments in forums such as the G20 and the Financial Stability Board (FSB). These projects may be elevated to priority status if and when required.

1.4 PRIORITY PROJECTS

The Strategic Plan 2011-2014 defines a number of priority projects for which the FRC intends to take a thought leadership role. These projects are being progressed by establishing Task Forces of three or more members, including a chairman who is an FRC Member and in some cases selected non-FRC members. A summary of the Task Forces and their members is provided in the table below:

Task Force	Chairman	Members
Integrated reporting	John Stanhope	Merran Kelsall Kevin Simpkins Kevin Stevenson Jan West AM
Reducing complexity in financial reporting	Bruce Brook	Michael Coleman Michael Dwyer Kevin Stevenson Judith Downes* Tanya Branwhite* Rob Ward*
Promoting board understanding of financial reporting	Kevin Lewis	Ian Laughlin Klaus Zimmermann
Monitoring of audit independence and other audit quality drivers	Michael Coleman	Noelle Kelleher Merran Kelsall Vas Kolesnikoff Lee White* (from August 2011)
Public sector financial reporting, including evaluation of IPSAS	Grant Hehir	Stein Helgeby Kevin Simpkins Kevin Stevenson Robert Williams* *denotes non-FRC member

The general scope and expected outcomes of the work of the Task Forces have been agreed. The main objective of each Task Force is to conduct an initial scoping with a view to producing a high-level identification of the key issues and possible solutions. Solutions that are straightforward to adopt will be recommended to the FRC for implementation. If further, more detailed work appears to be justified, the matter will be reported back to the FRC and the FRC will then decide whether to commission the work.

Further detail on the activities of each of the Task Forces is provided in section 2.3.

A further priority has been to update and improve the FRC website. A number of changes have been made, including removing outdated information, uploading recent key documents, presenting information in a consistent manner, improving the functionality of the site by updating links, and changing the structure of the site to provide a sharper focus on key information. Going forward it is intended to make more systematic use of the website in communicating with stakeholders.

2 OVERSIGHT OF AUSTRALIAN STANDARDS SETTING

2.1 INTRODUCTION

Under the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the FRC's functions are 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 2010-11 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.

2.2 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 certain advice and determining their broad strategic directions.

2.2.1 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 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 2011 is listed in the table below.

Committee	Chairman	Members
Nominations Committee	Jan West AM	Lynn Wood Mark Coughlin Merran Kelsall Kevin Stevenson Klaus Zimmermann

The FRC would like to thank Klaus Zimmermann for his contribution as the previous Chairman of the Nominations Committee. Mr Zimmermann retired from the position at the end of 2010 and has been succeeded by Ms Jan West.

The following appointments and re-appointments to the Boards for terms commencing on 1 January 2011 and ending on 31 December 2013 (unless otherwise shown) were approved by the FRC on 2 December 2010:

- AASB: appointment of Ms Anna Crawford, Professor Jayne Godfrey and Dr Roger Sexton and re-appointment of Mr Mark Jenkin and Mr Robert Williams; and
- AUASB: appointment of Mr Bernie Szentirmay and Ms Kristen Wydell and re-appointment of Ms Valerie Clifford, Mr John Gavens and Mr Jon Tyers.

The FRC would like to thank the following AASB and AUASB members who left during 2010-11 for their contributions: Mr Frank Palmer, Mr Bruce Porter, Ms Joanna Perry, Mr Chris Hall and Professor Christine Jubb.

As at 30 June 2011, the AASB had 13 members while the AUASB had 11 members.

2.2.2 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.

2.2.3 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 Council 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 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.

2.3 MONITORING AND INFLUENCING AUSTRALIAN DEVELOPMENTS

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 Council members and through an ongoing program of visits by the FRC Chairman with stakeholders.

2.3.1 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 on key strategic issues through the work of the FRC Task Forces.

The work of the FRC Task Forces is expected to be of strong interest to the financial reporting community in Australia, based on the importance and high impact of the strategic issues that they are tackling. As a consequence, the Task Forces have engaged in a variety of ways with stakeholders, including by asking them for information, consulting specific stakeholders on key matters, and in some cases inviting stakeholders to nominate Task Force members.

Both the former and current FRC Chairman 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, especially in relation to the Strategic Plan, or discuss matters of particular interest to the stakeholder.

Both the former and the current Chairman accepted invitations from the Australian Public Policy Committee (APPC) to participate in their meetings. The APPC has a

membership consisting of representatives of key accounting firms and bodies, and meets regularly to discuss key financial reporting matters. Mr Lucy gave an update on the latest developments with respect to IFRS and the convergence program between the IASB and the Financial Accounting Standards Board (FASB) of the USA. Ms Wood presented the FRC Strategic Plan 2011-14 and discussed its contents with APPC members. A range of ideas were put forward for the FRC to consider for inclusion in its work agenda.

The current Chairman had an initial meeting with the Parliamentary Secretary to the Treasurer, the Hon David Bradbury MP, taking the opportunity to update him on the work of the FRC and on the Strategic Plan in particular. The Parliamentary Secretary, who is responsible for the FRC, expressed strong interest in the work of the FRC, and indicated that he would like to be kept updated on its progress. The FRC Chairman intends to meet the Minister regularly to provide him with updates on the activities of the FRC.

2.3.2 Integrated Reporting

Integrated Reporting is a term that refers to a reporting model that goes beyond purely financial statements and includes other key information relating to the entity. There is no standard definition of the term, and it may refer to reporting that includes environmental, social, governance or business risk-related information and also consideration of sustainability issues.

Integrated Reporting is one of the most widely discussed new concepts related to the financial reporting field, both within and outside Australia. It was identified as one of the key strategic issues that ought to be considered by the FRC in the Strategic Plan, and a Task Force has been established to address it.

The International Integrated Reporting Committee (IIRC), established in 2010, seeks to create a globally accepted integrated reporting framework which brings together related information in a clear, concise, consistent and comparable format. The IIRC includes many key stakeholders including from companies, investors, regulators and standard-setters, intergovernmental organizations, the accounting profession, civil society and academia. The IIRC has recently published a discussion paper and aims to have this paper discussed by the G20.

An integrated reporting Task Force was created by the FRC following its 18 May meeting. Its 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 other organisations already active in Australia.

The Task Force had its first meeting in early June 2011, and decided to consult FRC stakeholders on their current views and activities relating to integrated reporting, and

to gather other information regarding integrated reporting and Australian participation in international processes. Once it has examined all the information, including the IIRC's discussion paper, it will decide its future work program.

2.3.3 Reducing complexity

Financial reports are widely criticised for being too voluminous and complex. The FRC has been discussing this issue for some time, and it was identified as a strategic issue in the Strategic Plan, with a Task Force established to suggest improvements.

The Reducing Complexity Task Force is to consider the information needs of current and future users of financial reports and recommend changes to the reporting regime for financial reporting disclosures. The project is to be divided into two phases:

- a short to medium term objective of achieving a significant reduction in the level of complexity and volume when compared with the current requirements. It is intended that this change should be achieved through an evolutionary process; and
- a long term objective of furthering the debate around a conceptual framework for financial reporting so as to deliver optimised financial reporting for the future.

In undertaking the project, the Task Force will:

- consider Australian and overseas publications that examine ways of reducing complexity in financial reports;
- examine surveys of the information needs of users and preparers of financial statements; and
- consult the FRC's stakeholders to obtain their views on financial reporting-related issues for preparers of financial reports and the information needs of informed investors.

The FRC has also been monitoring a number of other initiatives that are designed to reduce complexity. These include the reforms in the not-for-profit sector announced by the Government as part of the 2011 Budget, which have the objective of simplifying the regulatory requirements applying to not-for-profit entities and reducing red tape. The main measures include the establishment of an independent statutory office – the Australian Charities and Not-for-profits Commission – by 1 July 2012 and discussions to progress national regulation and a national regulator for the not-for-profit sector through the Council of Australian Governments. The FRC intends to monitor the Government's work in this area, and to participate in and influence the debate to the extent it concerns financial reporting matters.

The FRC is monitoring a range of issues arising from the Government's Corporate Reporting Reform Act in 2010, including in relation to the dividends test and parent entity reporting, as well as the implementation of the AASB's Reduced Disclosure Requirements (RDR) standard and the second stage of the AASB's work on this project.

2.3.4 Promoting board education

The nature and extent of understanding of financial reporting matters amongst company board members is an issue that has gained prominence in today's corporate landscape. The FRC has also been discussing this issue, and it was identified as a strategic issue in the Strategic Plan, with an FRC Task Force established to consider the issue more closely.

In the FRC's view, the delivery of the Centro court case (*ASIC v Healey & Ors [2011] FCA 717*) on 27 June 2011 has added impetus to the importance and timeliness of the Task Force's work. This case concerned the roles and responsibilities of directors in relation to financial reporting. Middleton J found that directors have a duty and responsibility to read and understand the contents of financial statements before approving them to ensure, as far as possible and reasonable, that the information included in them is accurate. Directors are expected to be familiar with the fundamental business of the company and be financially literate to understand basic accounting conventions.

The Task Force has met on three occasions to discuss its objectives and strategy. It plans to conduct a fact-finding exercise, through the use of targeted questionnaires to directors and to accounting, auditing and actuarial professionals, to elicit views about the extent of understanding of financial reporting amongst company boards. The questionnaires will seek to identify the possible causes and cures for any gaps in that regard.

2.3.5 Audit quality

The FRC wrote to the European Commission (EC) on 14 December 2010 advising the EC of the considerable interest among a wide range of stakeholders in Australia, including government, regulators, audit firms, professional accounting bodies and standard setters, in the EC's Green Paper *Audit Policy: Lessons from the Crisis*. The FRC drew the EC's attention to the Treasury's consultation paper *Audit Quality in Australia: Strategic Review* which the former FRC Chairman released in March 2010.

The FRC is monitoring progress on the Government's proposed reforms in response to Treasury's audit quality paper, particularly as one of the measures may include changes to the FRC's existing auditor independence functions. The FRC was represented at the roundtable meetings which Treasury conducted with stakeholders

in November 2010 to discuss possible reform proposals arising from Treasury's audit quality paper.

In 2011 the FRC decided that audit quality is a strategic issue for the FRC and the Audit Quality Task Force was established to focus on this issue. The Task Force identified recent key publications, reports and other initiatives in relation to audit quality in Australia, in other jurisdictions and at the international level for the purpose of formulating its work program for 2011-12.

2.3.6 Public sector financial reporting

The FRC discussed the issue of public sector financial reporting standards, including the role of the international public sector accounting standards (IPSAS) issued by the International Public Sector Accounting Standards Board (IPSASB) in Australia. It was decided in the FRC meeting of 2 December 2010 that the AASB and the Department of Finance and Deregulation should monitor developments over the next year and that it would be desirable to have a state representative involved in the work.

In 2011 the FRC decided that public sector financial reporting was a strategic issue for the FRC and the Public Sector Task Force was established to focus on this issue. The Task Force initially focused on drafting a response to a consultation paper issued by the International Federation of Accountants (IFAC) about the governance of the IPSASB. Two meetings of the Task Force were held in May and June 2011 and a draft submission was provided for discussion and approval by the FRC. The final FRC submission was provided to IFAC on 30 June 2011, and is available on the FRC website.

2.3.7 Other matters

The FRC is monitoring the Government response to the recommendations of the Super System Review (Cooper Review), especially in relation to new requirements proposed for auditors of Self Managed Super Funds.

The FRC discussed the Consultation Paper 150 'Disclosing Financial Information other than in accordance with Accounting Standards' issued by ASIC in March 2011 and decided to prepare a submission to the paper. The submission was sent to ASIC on 11 May 2011 and is available on the FRC website.

2.4 MONITORING AND INFLUENCING INTERNATIONAL DEVELOPMENTS

The 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 world-wide use with appropriate regard to international developments.

Much of the work of the IASB continued to focus on convergence between the IASB's accounting standards (IFRS), as adopted in Australia and the European Union (EU), and those of the FASB and the Accounting Standards Board of Japan. The convergence process, which is targeted at facilitating an eventual decision by the USA to adopt IFRS, has been progressing much as expected, although not strictly to the original timeline.

The SEC is expected to announce a decision on eventual adoption of IFRS by the USA later this year, while the Japanese Financial Services Agency (FSA-J) is expected to make a decision on Japanese adoption in 2012. Australia has a strong interest in both countries adopting IFRS.

A significant change occurred at the end of June 2011 when Sir David Tweedie retired as Chairman of the IASB after 10 years in the position. Over that period the IASB has succeeded in establishing IFRS as the accepted set of financial reporting standards in more than 100 countries. The new IASB chair, Hans Hoogervorst, is a former Dutch Finance Minister, and the Vice-Chairman, Ian Mackintosh, is a former chief accountant of ASIC, and has more than 30 years experience of national and international accounting standard-setting in Australia and the United Kingdom (UK). Australia was previously represented on the IASB by Warren McGregor, whose ten year term ended on 30 June 2011.

The FRC monitors international developments on an ongoing basis through a variety of mechanisms, including by receiving reports from Australian representatives on key international bodies such as the IFRS Foundation and the IAASB, maintaining contacts with important overseas persons and entities, and by cooperating with the Australian Treasury in participating in the ongoing global debate on financial reporting and its appropriate role in maintaining stability in the global financial system.

2.4.1 Stakeholder engagement

Between 1 and 16 July 2010, the former FRC Chairman and the then FRC Secretary conducted meetings with a range of bodies from the accounting and auditing communities of the UK, mainland Europe and the United States. Key entities visited included the EC, the IASB in London, the Financial Services Authority and the Financial Reporting Council in the UK (FRC-UK), and the SEC and the Public Company Accounting Oversight Board (PCAOB) in the USA. The main topics for discussion were the convergence agenda between the IASB and the FASB in the USA, the likelihood of the SEC deciding to adopt IFRS and possible improvements to the current approach for setting international auditing standards.

In February 2011 the former FRC Chairman and the FRC Secretary visited a number of key stakeholders in Tokyo, Japan. Talks with the FSA-J covered the IASB Chair search, the strategic reviews of the IFRS Foundation by the Trustees and the Monitoring Board, and the introduction of IFRS in Japan. Mr Lucy informed the FSA-J about the IFRS seminar held in Tokyo with the support and participation of the FRC (for details see below) and discussed the importance of the decision proposed to be made by the FSA-J in 2012 on IFRS adoption. FSA-J Commissioner Mikuniya expressed his gratitude to Jeffrey Lucy for his support for the establishment of the IASB satellite office in Japan. A meeting was also held with the Certified Public Accountants and Auditing Oversight Board (CPAAOB), which oversees the accounting and auditing profession in Japan. The CPAAOB was particularly interested in Australia's experiences following the adoption of International Standards on Auditing (ISAs), and whether their principles-based nature had caused interpretation problems between preparers and their auditors. Mr Lucy informed the CPAAOB that the Australian auditing standards, which are based on ISAs, are well accepted and have not caused problems of the kind mentioned.

The CEO of the FRC-UK, Stephen Haddrill, visited Australia in March 2011. The FRC assisted his office in arranging a suitable program of visits in Sydney and Melbourne, and arranged a program of stakeholder visits in Canberra which included meetings with Treasury, the Department of Finance and Deregulation and the Australian National Audit Office (ANAO). The opportunity was taken to exchange views on a range of topics of common interest, including public sector financial reporting and the proposals for audit reforms being discussed in the European Union. Mr Haddrill pointed out that there was a long process to go through following the release of the EC Green Paper on Audit Policy, and that the proposals in the paper could undergo some changes before being implemented.

In May 2011 the FRC Chairman, together with senior officials from Treasury and the Department of Finance and Deregulation, held a meeting in Canberra with Dr Andreas Bergmann, the Chair of the IPSASB. The main part of the discussion focused on the governance of the IPSASB, and the forthcoming review conducted by IFAC on this topic. The importance of having adequate governance arrangements in place was

emphasised including, in the case of the IPSASB, an appropriate level of involvement of key public sector entities.

2.4.2 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 are the IFRS issued by the IASB for use in the preparation of general purpose financial statements. IFRS have been adopted by over 100 countries around the world, including the all members of the European Union and increasing numbers of countries in the Asia-Oceania region. Australia was one of the earliest adopters of IFRS, which have had force of law under the Corporations Act since 2005. The Australian Government, through the FRC, provided financial support to the work of the IASB through a grant of \$1 million in the period covered by this report.

The Foundation has 22 Trustees, who have senior executive experience and who come from diverse geographical and professional backgrounds in both the private and public sectors. The former FRC Chairman, Jeffrey Lucy, is one of the Trustees. In this capacity he attended a number of Trustees' meetings during the year. Costs associated with Mr Lucy's attendance at these meetings were met by the Foundation.

The FRC Secretary accompanied Mr Lucy to two of the Trustees' meetings. The first was the meeting of the Trustees of the IFRS Foundation held in Washington on 4-6 July 2010. The meeting mainly discussed the forthcoming strategic review by the Trustees to consider the scope and mission of the IFRS Foundation, its governance arrangements, the effectiveness of the standard-setting process and financing arrangements. During the meeting Mr Lucy organised and led a separate meeting of the Asia-Oceania trustees which discussed ways to strengthen regional cooperation and increase the influence of the region in global standards setting.

The second meeting attended by Mr Lucy and the FRC Secretary was held in Tokyo on 9-11 February 2011. Key matters discussed included the search for a new IASB chairman, status of the convergence projects between the IASB and the FASB, ensuring the consistent application of IFRS around the world, and the strategic reviews being conducted by the Trustees and separately by the Monitoring Board, which is the supervisory organ overseeing the activities of the IFRS Foundation. Masamichi Kono, the chair of the working group conducting the Monitoring Board review, made a presentation at the meeting emphasising the willingness of the Monitoring Board to work with the Trustees to ensure that the two reviews do not produce contradictory findings.

The Trustees also made a formal decision to establish an Asia-Oceania liaison office in Tokyo to facilitate communications between the IFRS Foundation and stakeholders in the region. The office is expected to open in the second half of 2012. This is an

important announcement which reflects the growing importance of the region as a key influence on the work of the IFRS Foundation and the IASB.

The FRC made submissions on both the IFRS Foundation Trustees' Strategy Review and the Monitoring Board Consultative Report. Key points in the submissions included:

- the urgent need to coordinate the work of the two reviews;
- the desirability for the IASB to broaden the scope of its standards, especially to include public sector financial reporting;
- the need to improve the governance of the IFRS Foundation and the Monitoring Board, in particular to clarify the respective responsibilities of the two entities, and to ensure proper accountability for the Monitoring Board; and
- the need to establish a solid funding base for the IFRS Foundation, based on a model of public funding contributed by adopting countries in proportion to their Gross Domestic Product.

In March 2011, when Sir David Tweedie paid his last official visit to Australia, the FRC organised a visit to Canberra which included a meeting with the Parliamentary Secretary to the Treasurer, the Hon David Bradbury MP, and a roundtable discussion with key stakeholders such as the Department of Finance and Deregulation and the ANAO. In addition, a special FRC meeting was held in Sydney on 4 March 2011 in which the former FRC Chairman, on behalf of the members, expressed his thanks for Sir David's contribution to financial reporting and the realisation of the goal of a single set of high quality global accounting standards. He also expressed his thanks to Mr McGregor for his ten years of service on the IASB. Sir David responded by emphasising the importance of Australia's contribution to financial reporting in general, and particularly of its early decision to adopt IFRS, which had been an crucial factor driving the subsequent rapid spread of IFRS around the world. In his discussion of the current work of the IASB he talked about the importance of Asia-Oceania in general and made special reference to the contributions of the Asian-Oceanian Standard-Setters Group (AOSSG). The AOSSG is a grouping of regional accounting standard setters which is becoming increasingly influential in international standard-setting (see section 2.4.3 below).

Merran Kelsall, Chairman of the AUASB and FRC Member, was appointed as a member of the IAASB for a term of three years from 1 January 2011. The IAASB is responsible for setting international standards on auditing and assurance. The Australian Auditing Standards released by the AUASB are generally based on the IAASB's international standards. Ms Kelsall's appointment gives Australia an ideal opportunity to influence international thinking and the development of appropriate standards and guidance on audit and assurance for the global environment. She will also be in an excellent position to keep the FRC updated on key developments.

The FRC during the year monitored significant activities by the G20 and the FSB relevant for the financial reporting community, primarily through briefings provided by Treasury. The main issues considered by the G20 and the FSB were the convergence projects pursued by the IASB and FASB. The G20 has also closely monitored the development of the replacement financial instruments standards by the IASB and FASB, and the improvement of the IASB's governance. The FSB is considering whether to do some work on the possible role of audit reports in promoting financial stability.

2.4.3 Monitoring and influencing regional convergence

IFRS Regional Policy Forum

The 5th IFRS Regional Policy Forum was held in Bali, Indonesia from 23 -24 May 2011. The conference was hosted by the Indonesian Institute of Accountants and was attended by over 300 participants from 21 jurisdictions in the Asia-Oceania region. The IFRS Foundation was represented by Jeffrey Lucy, Trustee, Sir David Tweedie, Chairman of the IASB, and IASB board members including Warren McGregor. In addition to Mr Lucy and Mr McGregor, Australia was represented by the FRC Chairman and Secretary, the Chairman of the AASB, senior Australian Treasury officials and members of the accounting profession. Speakers included representatives of ASIC and the Australian Taxation Office.

The conference focused on the challenges and opportunities of IFRS adoption, which was held to be the topic of most relevance in the region given that many countries represented at the conference are at some point of progression towards IFRS adoption. Progress reports were given by a number of key regional jurisdictions, together with accounts of particular problems and challenges that had been encountered, such as conflicts with existing taxation treatments or corporations law requirements. Other presentations and discussions focused on issues such as opportunities and challenges faced by auditors, preparers of financial statements and regulators.

Key outcomes included agreement among participants that outright adoption of IFRS must be the ultimate objective in order to achieve a single set of high quality global accounting standards, even if a process of convergence may have a role to play in achieving this objective. Participants were also keen to promote more cooperation among jurisdictions to increase the region's influence on global accounting standard setting, and agreed that AOSSG was the ideal forum in which to foster such cooperation.

It was agreed that the next IFRS Regional Policy Forum will be held in Malaysia in 2012.

Asian-Oceania 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
- Cooperate with governments and regulators and other regional and international organisations to improve the quality of financial reporting in the region.

AOSSG currently has 25 members. The current Chair is the Chairman of the Accounting Standards Board of Japan, while the Vice-chair is the Chairman of the Australian Accounting Standards Board. The AASB is one of the most active members of the AOSSG, and makes an important contribution to many of its key projects.

Since its establishment in 2009 the AOSSG has continued to expand its membership and its activities. It is widely regarded as an outstanding success and an example of how regional cooperation in international accounting standard setting should operate. AOSSG has now established itself as one of the most important stakeholders of the IASB and the IFRS Foundation, which is illustrated by the fact that the Foundation's first regional liaison office is being established in this region (in Tokyo – see section 2.4.2).

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. The next AOSSG Annual Meeting will be held in Melbourne in November 2011.

IFRS Seminar in Japan

The former FRC Chairman and FRC Member Bruce Brook participated in a seminar organised by the Japanese Institute of CPAs with the title 'IFRS Practical Implementation – Learning from Australia'. The main focus of the presentations and discussions was the cost implications for preparers in adopting IFRS. Both Mr Lucy and Mr Brook gave presentations outlining Australia's experience in adopting IFRS. The main message communicated by the Australian speakers was that, while there were costs in adopting IFRS for preparers, they were (in Australia's case) outweighed by significant benefits, for example in facilitating access by domestic companies to the global capital markets. The seminar was an outstanding success, and attracted over 800 participants.

India

In November 2010, Treasury hosted the visit of an Indian delegation led by the Secretary of the Ministry of Corporate Affairs and also including a number of representatives of the Institute of Chartered Accountants of India. A meeting was held in Canberra for the delegation to meet the former FRC Chairman and a representative of the AASB and hear a presentation on Australia's experience in adopting IFRS. The Indian delegation in return gave an account of India's efforts to converge to IFRS and the problems they were encountering during this process. Significant issues in this respect include problems with tax treatments and corporations law requirements. The delegation also met with other units within Treasury, and with regulatory and quasi-regulatory bodies such as ASIC and the Australian Securities Exchange (ASX).

The FRC notes that Treasury's designated representative in India, Matt Croke, held a meeting with the Institute of Chartered Accountants in March 2011 in New Delhi during which he discussed India's IFRS convergence program and possible assistance that Australia could offer. A number of ideas were mentioned and follow-up discussions are taking place. Mr Croke is now stationed at the High Commission in New Delhi and has expressed his willingness to assist the FRC in serving as a useful point of contact with the Indian authorities and other counterparts in the subcontinent.

2.4.4 Trans-Tasman harmonisation

New financial reporting framework

The legislation establishing new institutional arrangements for standard setting in New Zealand, the Financial Reporting Amendment Act 2011, was passed and came into force on 1 July 2011. On that day the External Reporting Board (XRB), was established 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 XRB's structure contains three entities, the XRB Board and two standards 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). 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.

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.

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.

In 2010-11, TTAASAG progressed work in a number of areas, including by providing guidance on proposed regulatory and legislative reforms in both Australia and New Zealand, pursuing opportunities for collaboration between the standards-setting bodies in both countries, and promoting and facilitating greater engagement with the Asia-Pacific region particularly through the IFRS Regional Policy Forum held in Indonesia in May 2011.

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.

The FRC Chairmen who held office during 2010-11, attended the ASRB meetings throughout the periods covered by their respective memberships of the FRC.

Kevin Simpkins, Chairman of the ASRB (and now 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 FRSB, while Joanna Perry, Chairman of the FRSB, was a member of the AASB in 2010-2011.

Similar cross-appointment arrangements have been implemented under the new framework in New Zealand. Lynn Wood, Chairman of the FRC, is a member of the XRB Board, Kevin Stevenson, Chairman of the AASB, of the NZASB, and Merran Kelsall, Chairman of the AUASB, is a member of the NZAuASB. The respective cross-appointments from New Zealand are Kevin Simpkins, Michelle Embling, the Chair of the NZASB, and Neil Cherry, the Chair of the NZAuASB.

3 MONITORING AUDITOR INDEPENDENCE

3.1 INTRODUCTION

The ASIC Act provides that the FRC's functions include monitoring the effectiveness of auditor independence requirements in Australia and to give the Minister reports and advice about this matter. This part of the report has been prepared in accordance with section 235BA of the ASIC Act, which requires 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)¹; 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 guarantee²), large proprietary companies³ 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.

1 In December 2010, the Accounting Professional and Ethical Standards Board (APESB) released a revised *Code of Ethics for Professional Accountants* (APES 110). The revised Code, which is effective from 1 July 2011, aligns Australia's professional requirements with international standards and includes Australian specific requirements relating to inadvertent violations and multiple threats to auditors' independence.

2 The *Corporations Amendment (Corporate Reporting Reform) Act 2010* introduced a three tiered differential reporting framework for companies limited by guarantee.

3 An ASIC class order, CO98/1417 Audit relief for proprietary companies, relieves some large proprietary companies from having their financial reports audited.

To complement the legislative and professional requirements on independence of auditors, appropriate institutional arrangements have been put 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 ASIC, the ASX, The Institute of Chartered Accountants in Australia (ICAA), CPA Australia, the Institute of Public Accountants (IPA), APESB, the Companies Auditors and Liquidators Disciplinary Board (CALDB) and the FRC.

3.2 SYSTEMS AND PROCESSES OF AUSTRALIAN AUDITORS

The ASIC Act requires 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 MOU with that body, by reviewing reports published by the ICAA and by requesting information from the professional accounting bodies under the terms of its MOUs with those bodies.

On the basis of its work during the period covered by this report, the FRC has not become aware of any evidence to suggest that the systems and processes used by audit firms to ensure compliance with auditor independence requirements are not working effectively.

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 2010-11 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 2010 or commenced after that date and were substantially completed by 30 June 2011. As in past years, the report by ASIC has constituted a key source of information for the FRC with respect to its responsibilities in this area during 2010-11.

In addition to the report to the FRC for the period 1 July 2010 to 30 June 2011, ASIC also issued a public report on its audit inspection program in June 2011 which covered the inspections of 21 firms completed in the period between 1 July 2009 and 31 December 2010. A copy of the public report is available on the ASIC website (www.asic.gov.au).

For the purposes of the report to the FRC on the 2010-11 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 and members of a global network with multiple offices;
- **other national and network firms** that are national partnerships or individual offices 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 year ended 30 June 2011, ASIC completed inspections of 13 selected firms: three were larger national firms, six were other national and network firms and four were smaller firms. With the exception of the four smaller firms, the larger national firms and the other national and network firms inspected during the year have been previously inspected at least once, with a large number of these firms being inspected a number of times. Three of these inspections were conducted jointly with the PCAOB.

Collectively, the 13 firms inspected by ASIC audit approximately 74 per cent by number and 88 per cent by market capitalisation of the 300 largest entities listed on the Australian Securities Exchange (S&P/ASX 300).⁴

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-scope inspection comprising the review of key quality control systems, policies and processes.
- 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.

4 The results of the analysis of audits undertaken by the firms is notably higher than that reported in the FRC's 2009-10 annual report because one of the national firms inspected during 2010-11 was not inspected during 2009-10. Source of data: Standard & Poor's website as at 28 July 2011.

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 and high quality audits.

Firms have implemented quality control systems to ensure compliance with the independence requirements of the Corporations Act and professional quality control and ethical standards. Although the extent and complexity of these systems vary depending on the size and nature of the firm, the implementation of quality control systems demonstrates that the firms understand their obligation to comply with these requirements.

ASIC has indicated that the results of its first inspection of a firm often indicate that some aspects of quality control have not been addressed or fully developed. Subsequent inspections of a firm almost always show a marked improvement in most, if not all, areas identified in the first inspection.

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

Larger national firms

Three larger national firms were inspected by ASIC during 2010-11. 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 that this commitment continues to have a positive impact on maintaining a culture of audit independence and generally, there are few, if any, findings in this area for the larger national firms.

The larger national firms also require partners and senior staff to disclose their investments on interactive databases that are automatically matched with the firms' prohibited securities lists. ASIC has informed the FRC that, during 2010-11, the larger national firms continued to monitor how partners complied with these policies and systems.

ASIC also reported that, while the firms continue to identify instances of non-compliance with their own policies that include requirements that go further than the Corporations Act, the number of instances of non-compliance has not increased compared to prior years.

Other national and network firms

Six other national and network firms were inspected by ASIC during 2010-11. 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 and contraventions of the rotation and independence requirements of the Corporations Act.

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'. It is ASIC's view that, where relevant, firms should take appropriate action against personnel that contravene the independence requirements of the Corporations Act and the firms' own independence policies.

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 does not have a policy requiring pre-approval for the performance of non-audit services. Another firm has policies and procedures about the approval of non-audit services but the policies do not appear to be monitored for compliance;
 - in one firm, the policy setting out the consequences for breach of independence requirements of the Corporations Act and the firm's policies and disciplinary measures should be more transparent to staff, while another firm needs to incorporate the consequences of breaching independence requirements into its policies;
 - two firms need to include familiarity threats created by long association for non-listed assurance clients in their independence policies;
 - one firm does not specifically include independence and commitment to ethical principles in its staff evaluation and compensation process. Including

independence as an explicit factor in the staff evaluation and compensation process would provide a clear message from the firm's leadership about the overriding importance of independence;

- one firm needs to improve its independence consultation processes to ensure that consultations are undertaken as appropriate and approvals are documented and communicated in accordance with the firm's policy;
- one firm needs to consider defining clear responsibilities for the partner responsible for independence monitoring; and
- one firm needs to:
 - : amend its systems and processes to better monitor compliance with its policy prohibiting the promotion of audit clients by its wealth management division;
 - : update its independence policies to remove quantitative thresholds for determination of materiality of indirect financial interests, which appear to create undue focus on the relative size of indirect financial interests in audit clients relative to other significant factors; and
 - : improve the effectiveness of its auditor rotation monitoring by tracking previous partner involvements in listed audit engagements.
- *Testing independence systems:* Four of the six other national and network firms inspected during the period do not test their independence systems and processes, including the provision of non-audit services, 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. However, 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

Four smaller firms were inspected by ASIC during the period covered by this report. ASIC has informed the FRC that its consideration of smaller firms' compliance with the independence requirements of the Corporations Act was limited to high level enquiries with the firms' leadership and independence related matters documented on the audit engagement file that was selected for review. 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.

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 also observed that one smaller firm relied on a national database for independence and conflict checking when accepting a new client. However, the firm did not obtain positive confirmations from all partners and directors regarding potential independence threats and conflicts when assessing the acceptance of a new listed client.

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 commenced an investigation of potential contraventions of the Corporations Act by a (Registered Company Auditor (RCA) from a smaller firm based on a complaint that the auditor held financial interests in and owed amounts to an audited body. The investigation is currently in progress and ASIC has advised that it will be considering potential regulatory action against the auditor in relation to the auditor independence contraventions and related audit quality aspects.

In addition, ASIC has provided the FRC with an update on two conflicts of interest matters mentioned in its 2010 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. This matter has been investigated by ASIC, which is currently considering its options.
 - In the other matter, a number of situations arose because financial interests were held in audited bodies and an audit client held shares in a company directly related to one Other National and Network Firm. ASIC reports that, in mid 2011, it undertook another inspection of the firm and that further discussions have been held with the firm regarding these matters.
- *Consent to resign as auditor:* ASIC received 13 applications from auditors (six from smaller firms, four from other national and network firms and three from larger national firms) seeking consent to resign from an audit during 2010-11. In each of these cases, 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 seven

cases. In the other six cases (five where an employee of the audit firm was/became a member of the audited body and one where an employee of the audit firm had an asset that is an investment in 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:* During 2010-11, ASIC received two notifications of breaches of auditor rotation requirements from other national and network firms:
 - in one case, the quality control system within the firm identified the breach and the auditor was rotated off the engagement as soon as the firm was aware of the breach. The auditor's independence declaration in the financial report of the audited body for the subsequent period disclosed the breach and the remedial action taken by the firm; and
 - in the other case, the auditor was allocated some audit clients when another auditor ceased employment with the firm. The auditor's involvement resulted in a breach of the auditor rotation requirements under subsection 324DA(1) of the Corporations Act. ASIC has advised the FRC that this matter is being followed up as part of its current inspection of the firm.
- *Relief from the auditor rotation requirements:* Under subsection 342DA(1) 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 2010-11 it received two applications from auditors seeking an extension of the rotation period under the Act:
 - in one case, the auditor claimed unreasonable burden on the company and the auditor due to staff resignations and a need for specialist auditor experience associated with complex business transactions. The application was refused as no unreasonable burden was evident. In ASIC's view there were other auditors within the firm capable of performing the audit.
 - in the second case, the auditor, who was the only partner left in the firm following the resignation of one and the death of another, made application for relief from the auditor rotation requirements to allow him to act as lead auditor for another financial year. Relief was granted to this auditor as he had appointed an external quality control reviewer for all of his listed entity engagements.

3.3 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 responsive action taken 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 2010-11, 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.

Quality review programs

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 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 2011, it completed reviews of 432 practices with 78 per cent of the 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 2010-11 found that one 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 72 per cent of the practices that conduct Corporations Act audits and 80 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 to four practitioners; non-mid-tier practices with five or more practitioners; mid-tier practices; and Big 4. During 2010-11, the proportion of practices reviewed in each size category reflected the approximate distribution of practices by size across the ICAA as a whole. The only exception is for the Big 4 firms, which were reviewed by the Audit Quality Review Board (AQRB) for the three years to 2009, with those reviews being relied on by the ICAA. The ICAA has advised the FRC that, as the AQRB has completed its mandate, ICAA reviews of the Big 4 are resuming.

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 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 2010-11 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 (9 per cent of the 432 practices reviewed);
- appropriate safeguards were not adequately applied when carrying out auditing and accounting functions for a client (9 per cent of practices reviewed); and
- auditing the self-managed superannuation fund of a partner in their practice (4 per cent of practices reviewed).

CPA Australia

CPA Australia has advised the FRC that as at 30 June 2010, 5,690 of its members held a CPA Australia Public Practice Certificate (PPC) while 1,087 held an ICAA Practice

Certificate. All members who hold a PPC are subject to CPA Australia's Quality Assurance (QA) program. A total of 1,117 members are registered company auditors.

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 using a questionnaire specific to the particular type of service. 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. CPA Australia has advised the FRC that the General Quality Control Questionnaire used in the QA program includes an in-depth section on auditor independence which was last updated in June 2010.

In 2010-11, the reviews conducted under CPA Australia's QA program found that 82 per cent of those reviewed were either fully compliant or had only minor departures from professional standards.

During 2010-11, 78 breaches of auditor independence requirements were identified, with the vast majority relating to audits of Self Managed Superannuation Funds (SMSFs). Of the members who breached the auditor independence requirements, 19 were identified as RCAs.

For the 2011 calendar year, over 830 members (including 125 RCAs) are expected to complete a QA review. In addition, 150 follow-up reviews (including 49 of RCAs) are expected to be completed.

IPA

The IPA has informed the FRC that it requires all members who are issued with a PPC to undertake a 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 2010 to 30 June 2011, 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.

In the last quarter of 2010, the IPA initiated a pilot program in relation to the PPQA system. This pilot involved systematising online some of the data collected from members in relation to their practice and client base. The pilot was successful and, for the financial year 2011-12, all reviews will be using the new format. While the new system utilises the pre-existing format, it captures the data from the reviews automatically in a digital format. 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.

Disciplinary procedures

The professional accounting bodies have provided the FRC with the following information concerning disciplinary matters during the year ended 30 June 2011:

- The ICAA has informed the FRC that during the year ended 30 June 2011 there were two disciplinary cases involving a breach of the ICAA's auditor independence requirements, both arising from referrals by the Australian Taxation Office and relating to the audit of self managed superannuation funds. One member had audited a fund where he was also the accountant of the fund, while the other member had audited his own fund in one financial period, and then entered into a reciprocal arrangement with a business associate to audit each other's funds. The first member was severely reprimanded and the second was reprimanded. Details of the cases are available on the ICAA's website.
- CPA Australia has advised that its Disciplinary Tribunal made three adverse finding against members relating to auditor independence. All of these adverse findings related to audits of SMSFs. 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.
- The IPA reports that it has not taken any disciplinary action in 2010-11 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 is aware of the referral of any members to the CALDB during the year ended 30 June 2011 for a breach of auditor independence requirements.

3.4 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 2010-11, 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.

3.5 AUDIT-RELATED DISCLOSURE REQUIREMENTS

The FRC is 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 that the FRC has entered into with ASIC provides 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 2010 and 31 December 2010. Section 307C independence declarations were also examined as part of its audit inspection program. ASIC has reported that no 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.

3.6 INTERNATIONAL DEVELOPMENTS IN AUDITOR INDEPENDENCE

Paragraph 225(2B)(e) of the ASIC Act provides that the FRC is 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 advice on any additional measures needed to enhance the independence of Australian auditors.

The FRC undertakes 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 2010-11, 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:

- European Commission (EC) Green Paper *Audit Policy – Lessons from the Crisis*⁵: The EC's paper was issued in October 2010, with the objective of opening a debate on the role of the auditor, the governance and independence of audit firms, the supervision of auditors, the configuration of the audit market, the creation of a single market for the provision of audit services, the simplification of rules for Small and Medium Sized Enterprises and Practitioners and international co-operation for the supervision of global audit networks. 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 hosted a high level conference on its paper on 9-10 February 2011 and is currently analysing written submissions and the contributions made at the conference.
- During 2010-11 the US PCAOB undertook a range of work on audit-related issues such as rethinking the relevance, credibility and transparency of audits. In August 2011, while this report was being prepared, the PCAOB issued a *Concept Release on Auditor Independence and Audit Firm Rotation*.⁶ The release seeks public comment on ways that auditor independence, objectivity and professional

5 The EC's Green Paper can be accessed at: http://ec.europa.eu/internal_market/consultations/docs/2010/audit/green_paper_audit_en.pdf

6 The PCAOB's Concept Release can be accessed at http://pcaobus.org/Rules/Rulemaking/Docket037/Release_2011-006.pdf

scepticism can be enhanced, including through mandatory rotation of audit firms.

The FRC will maintain a watching brief on these developments through the Audit Quality Task Force to determine whether there are any ramifications for Australia's auditor independence requirements.

4 GOVERNANCE AND ADMINISTRATION

4.1 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, monitoring the effectiveness of the auditor independence regime, and advising the Minister on these matters. A summary of the FRC's statutory functions appears in Appendix C.

The FRC operates within a framework set out in Part 12 of the ASIC Act. The 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.

4.2 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 2011, the FRC had 18 members. During 2010-11, five members retired while four new members were appointed. A full list of members during 2010-11, and the stakeholders who nominated them, is in Appendix B.

Three ordinary meetings of the FRC were held during 2010-11. In addition, a special meeting of available Council members was held in March to enable Council members to discuss IFRS-related issues with Sir David Tweedie during his last visit to Australia in the capacity of Chairman of the IASB.

4.3 CONSULTANTS

During 2010-11, no consultants were engaged to perform work on behalf of the FRC.

4.4 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.

4.5 FINANCES

In 2010-11, 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.

4.6 FREEDOM OF INFORMATION

Statement covering the period from 1 July 2010 to 30 April 2011

The FRC has a website, www.frc.gov.au, which describes its functions and on which the minutes of its meetings, submissions to other organisations, rules of procedure and annual reports are publicly available.

The website also provides the contact details for the FRC Secretary.

Statement covering the period from 1 May 2011 to 30 June 2011

From 1 May 2011, agencies subject to the Freedom of Information Act 1982 (FOI Act) are 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 2010-11.

4.7 REGULATORY IMPACT STATEMENTS

The FRC did not submit any regulatory impact statements in 2010-11.

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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

General⁷

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 are instead having 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.

⁷ The material in this section is based on a summary provided by Professor the Hon Stephen Martin, Chief Executive, CEDA, following CEDA's recent 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 be now 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
Integrated 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>	Task force to be established as soon as possible following the 18 April FRC meeting. First progress report delivered at the June FRC meeting.
Reducing complexity in 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>	Task force to be established at the June FRC meeting. First progress report delivered at the September FRC meeting.
Promoting board understanding of financial reporting	<p>Establishment of a task force (Board Education Task Force)</p>	Task force to be established at the June FRC meeting. First progress report delivered at the September FRC meeting.
Monitoring of audit independence and other audit quality drivers	<p>Establishment of a task force (Audit Quality Task Force)</p>	Task force to be established at the June FRC meeting. First progress report delivered at the September FRC meeting.
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>	Task force to be established as soon as possible following the 18 April FRC meeting. First progress report delivered at the June FRC meeting.

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	Method of implementation	Timing
Oversight of standard setting processes and providing feedback/advice to the boards	Provision of relevant reports to the FRC, with responses provided as and when necessary	Ongoing
Influencing convergence globally and in the region	<p>Responding to relevant consultations, for example, by IASB or the Monitoring Board.</p> <p>Support for relevant AASB and AUASB activities, for example, Asia-Oceanian Standard-Setters Group (AOSSG) annual meeting.</p> <p>Visits to regional and global partners.</p> <p>Support for relevant events such as the Regional Policy Forum and the recent IFRS seminar in Japan.</p>	Ongoing
Trans-Tasman harmonisation	Provision of relevant reports to the FRC	Ongoing
Monitoring private sector not-for-profit financial reporting developments	<p>Secretariat to maintain contact with relevant Treasury units working on private sector not-for-profits (NFPs) reform.</p> <p>Provision of reports to the FRC on developments.</p> <p>Includes the issue of multiple sources of financial reporting requirements creating complexity and excessive regulatory burdens for private sector NFPs.</p> <p>Project may be elevated to a higher priority at the appropriate time.</p>	Ongoing
Monitoring the reform of auditing and other requirements as part of the Government's response to the Cooper report	<p>Secretariat to maintain contact with relevant Treasury units working on the Government's response.</p> <p>Provision of reports to the FRC on developments.</p>	Ongoing
Monitor and Influence G20 and FSB developments	<p>Secretariat to maintain contact with relevant Treasury units.</p> <p>Provision of reports to the FRC on developments and advice from relevant members.</p>	Ongoing
Consultation documents involving financial reporting issues	<p>For discussion in FRC.</p> <p>Members may provide written views for inclusion on the meeting agenda for discussion in the FRC.</p> <p>FRC may respond depending on members' views.</p>	Ongoing

This plan will be reviewed once in every year.

MEMBERS OF THE FINANCIAL REPORTING COUNCIL 1 JULY 2010 TO 30 JUNE 2011

Chairman

Jeffrey Lucy AM Nominated by the Australian Government
Appointed from 11 December 2007 to 10 December 2010; reappointed from
11 December 2010 to 10 March 2011

Lynn Wood Nominated by the Australian Government
Appointed from 11 March 2011 to 10 March 2014

Deputy Chairman

Michael Coleman Company Director, Sydney
Nominated by the Australian Institute of Company Directors
Appointed from 22 September 2006 to 31 October 2009; reappointed from
14 December 2009 to 13 December 2012

Members

Bruce Brook Company Director, Melbourne
Nominated by the Business Council of Australia
Appointed from 7 March 2006 to 6 March 2009; reappointed from 6 April 2009 to
5 July 2009, with an extension on 3 June 2009 to 2 June 2012

Don Challen Secretary, Tasmanian Department of Treasury and Finance, Hobart
Nominated by Heads of State and Territory Treasuries
Appointed from 6 January 2000 to 31 December 2002; reappointed from
7 March 2003 to 6 March 2005; 7 March 2005 to 6 September 2006,
22 September 2006 to 6 March 2008, and 29 July 2008 to 28 July 2011
Resigned 28 September 2010

Mark Coughlin Partner, PricewaterhouseCoopers, Adelaide
Nominated by CPA Australia
Appointed from 22 September 2006 to 31 October 2009; reappointed from
14 December 2009 to 2 June 2012

Michael Dwyer Member, Australian Securities and Investments Commission, Melbourne
Nominated by the Australian Securities and Investments Commission
Appointed from 3 June 2009 to 11 December 2011

Financial Reporting Council Annual Report 2010-11

John Gethin Jones	Consultant, Brisbane Nominated by the Financial Services Council (formerly the Investment and Financial Services Association) Appointed from 11 June 2006 to 10 June 2009; reappointed from 11 June 2009 to 10 June 2012 Resigned 18 May 2011
Grant Hehir	Secretary, Victorian Department of Treasury and Finance, Melbourne Nominated by Heads of State and Territory Treasuries Appointed from 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 Appointed from 24 February 2010 to 23 February 2013
Noelle Kelleher	Partner, Deloitte Touche Tohmatsu, Melbourne Nominated by the Association of Superannuation Funds of Australia Appointed from 3 June 2009 to 2 June 2012
Merran Kelsall	Chairman, Auditing and Assurance Standards Board, Melbourne Nominated by the Australian Government Appointed from 29 July 2008 to 9 August 2010; reappointed from 7 January 2011 to 6 April 2011, with an extension on 14 March 2011 to 9 August 2013
Vas Kolesnikoff	Chief Executive Officer, Australian Shareholders' Association Nominated by the Australian Shareholders' Association Appointed from 5 April 2011 to 4 April 2014
Ian Laughlin	Member, Australian Prudential Regulation Authority Nominated by Australian Prudential Regulation Authority Appointed from 1 July 2010 to 30 June 2013
Kevin Lewis	Chief Compliance Officer, Australian Securities Exchange, Sydney Nominated by the Australian Securities Exchange Appointed from 14 March 2011 to 13 March 2014
Eric Mayne	Chief Supervision Officer, Australian Securities Exchange, Sydney Nominated by the Australian Securities Exchange Appointed from 6 March 2006 to 26 February 2009; reappointed from 6 April 2009 to 5 July 2009, with an extension on 3 June 2009 to 2 June 2012 Resigned 27 August 2010
Jim Murphy	Executive Director, Markets Group, Australian Treasury, Canberra Nominated by the Australian Government Appointed from 7 March 2003 to 6 March 2006; reappointed from 7 March 2006 to 6 March 2009 and 6 April 2009 to 5 July 2009, with an extension on 3 June 2009 to 2 June 2012
Kevin Simpkins	Chair, Accounting Standards Review Board of New Zealand, Wellington Chair, External Reporting Board of New Zealand, Wellington (from 1 July 2011) Nominated by the New Zealand Minister of Commerce Appointed from 3 June 2009 to 28 February 2014

John Stanhope	<p>Chief Financial Officer and Group Managing Director, Finance and Administration, Telstra Corporation Limited, Melbourne</p> <p>Nominated by the Group of 100 Inc</p> <p>Appointed from 6 March 2006 to 26 February 2009; reappointed from 6 April 2009 to 5 July 2009, with an extension on 3 June 2009 to 2 June 2012</p>
Kevin Stevenson	<p>Chairman, Australian Accounting Standards Board</p> <p>Nominated by the Australian Government</p> <p>Appointed from 1 July 2009 to 30 June 2014</p>
Jan West AM	<p>Partner, Deloitte Touche Tohmatsu, Melbourne</p> <p>Nominated by The Institute of Chartered Accountants in Australia</p> <p>Appointed from 7 March 2005 to 6 March 2008; reappointed from 29 July 2008 to 28 July 2011</p>
Stuart Wilson	<p>Chief Executive, Australian Shareholders' Association</p> <p>Nominated by the Australian Shareholders' Association</p> <p>Appointed from 29 July 2008 to 28 July 2011</p> <p>Resigned December 2010</p>
Klaus Zimmermann	<p>Chief Executive Officer, Eldercare Incorporated, Adelaide</p> <p>Nominated by the Institute of Public Accountants (previously known as the National Institute of Accountants)</p> <p>Appointed from 7 March 2003 to 6 March 2006; reappointed from 7 March 2006 to 6 March 2009 and 6 April 2009 to 5 July 2009, with an extension on 3 June 2009 to 2 June 2012</p>

ATTENDANCE AT MEETINGS

FINANCIAL REPORTING COUNCIL

The FRC held three regular meetings during 2010-11. Members' attendance is shown in the table:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
J Lucy AM (Chairman to 10/3/11)	2	2	0
L Wood (Chairman from 11/3/11)	1	1	0
B Brook	3	3	0
D Challen	1	1	0
M Coleman	3	2	1
M Coughlin	3	3	0
M Dwyer	3	3	0
J Gethin Jones	3	0	3
G Hehir	1	1	0
S Helgeby	3	3	0
N Kelleher	3	3	0
M Kelsall	1(a)	0(a)	1
V Kolesnikoff	1	1	0
I Laughlin	3	3	0
K Lewis	1(b)	1(b)	0
E Mayne	0	0	0
J Murphy	3	3	0
K Simpkins	3	3	0
J Stanhope	3	1	2
K Stevenson	3	2	1
J West AM	3	3	0
S Wilson	2	2	0
K Zimmermann	3	2	1

(a) Prior to her reappointment to the FRC on 14 March 2011, Ms Kelsall attended two meetings as an observer.

(b) Prior to his appointment to the FRC on 14 March 2011, Mr Lewis attended two meetings as an observer.

FRC NOMINATIONS COMMITTEE

The FRC Nominations Committee held three formal meetings in 2010-11. Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
K Zimmermann (Chairman to December 2010)	3	3	0
J West AM (Chairman from January 2011)	3	3	0
D Challen	1	1	0
M Coughlin	3	3	0
M Kelsall	3	3	0
J Lucy AM	2	1	1
E Mayne	1	0	1
K Stevenson	3	3	0
L Wood	1	0	1

FRC TASK FORCES

As outlined in section 2 of this report, the FRC has established five Task Forces to progress a range of priority projects. Information about meetings of these Task Forces and the attendance of Task Force members at these meetings appears below.

A telephone meeting of Task Force chairmen was held on 22 June 2011, as a result of the cancellation of the scheduled FRC meeting due to flight restrictions announced the day before. FRC members who participated in this meeting were: Lynn Wood (FRC Chairman), Bruce Brook, Michael Coleman, Kevin Lewis, Jim Murphy and John Stanhope. Grant Hehir was unable to participate in the meeting, but was represented by Steve Mitsas.

AUDIT QUALITY TASK FORCE

This Task Force held no formal meetings in 2010-11. FRC Members of the Task Force are: Michael Coleman (Chairman), Noelle Kelleher, Merran Kelsall, Vas Kolesnikoff and Mark Coughlin.

BOARD EDUCATION TASK FORCE

This Task Force held one formal meeting in 2010-11. FRC Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
K Lewis (Chairman)	1	1	0
I Laughlin	1	1	0
K Zimmermann	1	1	0

INTEGRATED REPORTING TASK FORCE

This Task Force held one formal meeting in 2010-11. FRC Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
J Stanhope (Chairman)	1	1	0
M Kelsall	1	1	0
K Simpkins	1	1	0
K Stevenson	1	1	0
J West AM	1	1	0

PUBLIC SECTOR TASK FORCE

This Task Force held two formal meetings in 2010-11. FRC Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
G Hehir (Chairman)	2	0	2(a)
S Helgeby	2	2	0
K Simpkins	2	2	0
K Stevenson	2	2	0
R Williams (NSW Government)	2	1	1

(a) Mr Hehir was represented at both meetings by Mr Steve Mitsas.

REDUCING COMPLEXITY TASK FORCE

This Task Force held one formal meeting in 2010-11. FRC Members' attendance is shown in the table below:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
B Brook (Chairman)	1	1	0
M Coleman	1	0	1
M Dwyer	1	1	0
K Stevenson	1	1	0

SUMMARY OF THE FRC'S FUNCTIONS

FRC'S FUNCTIONS

Subsection 225(1) of the ASIC Act provides that the FRC's functions are:

- to provide broad oversight of the processes for setting accounting and auditing standards in Australia (paragraphs 225(1)(a) and (b));
- to monitor the effectiveness of auditor independence requirements in Australia (paragraph 225(1)(c));
- to give the Minister reports and advice about the matters referred to above (paragraph 225(1)(d));
- to establish appropriate consultative mechanisms (paragraph 225(1)(f)); and
- to advance and promote the main objects of Part 12 of the ASIC Act (paragraph 225(1)(g)).

In addition, paragraph 225(1)(h) of the ASIC Act provides that the FRC has any other functions that the Minister confers on it by written notice to the FRC Chairman.

SPECIFIC ACCOUNTING AND AUDITING STANDARDS SETTING FUNCTIONS

The FRC has the following specific accounting and auditing standard setting functions conferred on it under subsections 225(2) and (2A) of the ASIC Act:

- appointing the members of the AASB and AUASB (other than the Chairs, who are appointed by the Minister) (paragraphs 225(2)(a) and (2B)(a));
- giving the AASB and AUASB advice or feedback on their priorities, business plans and procedures (paragraphs 225(2)(b) and (2A)(b));

- giving the Offices of the AASB and AUASB advice or feedback on their budgets and staffing arrangements (including level, structure and composition of staffing) (paragraphs 225(2)(ba) and (2A)(ba));
- determining the AASB's and AUASB's broad strategic directions (paragraphs 225(2)(c) and (2A)(c));
- monitoring the development of international accounting and auditing standards and the accounting and auditing standards that apply in major international financial centres (paragraphs 225(2)(e) and (2A)(e));
- furthering the development of single sets of accounting and auditing standards for world-wide use with appropriate regard to international developments (paragraphs 225(2)(f) and (2A)(f));
- 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 (paragraphs 225(2)(g) and (2A)(g)); 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 the effectiveness of the consultative arrangements used by the AASB and AUASB (paragraphs 225(2)(h) and (2A)(h)).

SPECIFIC AUDITOR INDEPENDENCE FUNCTIONS

The FRC has the following specific auditor independence functions conferred on it under subsection 225(2B) of the ASIC Act:

- monitoring and assessing the nature, overall adequacy and effectiveness of:
 - the systems and processes used by Australian auditors to ensure compliance with auditor independence requirements (subparagraph 225(2B)(a)(i));
 - the systems and processes used by professional accounting bodies for planning and performing quality assurance reviews of audit work undertaken by Australian auditors to the extent to which those reviews relate to auditor independence requirements (subparagraph 225(2B)(a)(ii));
 - the action that Australian auditors who have been subject to such quality assurance reviews have taken in response to the reports prepared as a result of those reviews (subparagraph 225(2B)(a)(iii));

- the action taken by professional accounting bodies to ensure that Australian auditors who have been subject to such quality assurance reviews respond appropriately to the reports prepared as a result of those reviews (subparagraph 225(2B)(a)(iv)); and
- the investigation and disciplinary procedures of professional accounting bodies as those procedures apply to Australian auditors (subparagraph 225(2B)(a)(v));
- monitoring the overall compliance by companies, registered schemes and disclosing entities with the audit-related disclosure requirements of the Corporations Act and the accounting standards (paragraph 225(2B)(b));
- giving the Minister reports and advice about the matters referred to in the above paragraphs (paragraph 225(2B)(c));
- giving the professional accounting bodies reports and advice about matters related to their quality assurance reviews and disciplinary procedures as detailed in the above paragraphs (paragraph 225(2B)(d));
- monitoring international developments in auditor independence, assessing the adequacy of the Australian auditor independence requirements provided for in the Corporations Act and codes of professional conduct in the light of those developments and giving the Minister, and professional accounting bodies, reports and advice on any additional measures needed to enhance the independence of Australian auditors (paragraph 225(2B)(e)); and
- promoting, and monitoring the adequacy of, the teaching of professional and business ethics by, or on behalf of, professional accounting bodies to the extent to which the teaching of those subjects relates to auditor independence (paragraph 225(2B)(f)).

To facilitate the performance of the audit independence functions by the FRC, section 225A of the ASIC Act sets out powers that may be used by the FRC for gathering information from Australia's professional accounting bodies and Australian auditors.

AUDIT-RELATED DISCLOSURE REQUIREMENTS

The principal audit-related disclosure requirements of the Corporations Act and accounting standards are:

- paragraph 298(1AA)(c) of the Corporations Act, which requires a company (other than a company limited by guarantee), registered managed investment scheme or disclosing entity to include in its directors' report for each financial year a copy of the auditor's independence declaration under section 307C in relation to the audit for the financial year;
- paragraph 298(1AB)(b) of the Corporations Act, which requires a company limited by guarantee to include in its directors' report for each financial year a copy of the auditor's independence declaration under section 307C in relation to the audit or review for the financial year;
- section 300 of the Corporations Act, which requires the following information to be included in the directors' report of a listed company:
 - if a registered company auditor plays a significant role in the audit of a listed company for a financial year in reliance on a declaration made under section 342A⁸, subsection 300(11A) requires the report for the company to include details of the declaration;
 - in relation to each auditor:
 - : details of the amounts paid or payable to the auditor for non-audit services provided, during the year, by the auditor (or by another person or firm on the auditor's behalf);
 - : a statement of whether the directors are satisfied that the provision of non-audit services during the year by the auditor (or by another person or firm on the auditor's behalf) is compatible with the general

⁸ Section 342A of the Corporations Act outlines the circumstances, and manner, in which ASIC may modify the auditor rotation requirements contained in section 342DA of the Act.

standard of independence for auditors imposed by the Corporations Act; and

- : a statement of the directors' reasons for being satisfied that the provision of those non-audit services during the year by the auditor (or by another person or firm on the auditor's behalf) did not compromise the auditor independence requirements of the Corporations Act;
- subsection 306(2) of the Corporations Act, which provides that the directors' report of a disclosing entity must include a copy of the auditor's independence declaration under section 307C in relation to the audit or review of the half year; and
- paragraphs Aus 126.1 and Aus 126.2 of accounting standard AASB 101 *Presentation of Financial Statements*, which require an entity or economic entity to disclose in its financial report the remuneration of:
 - the auditor, showing separately amounts for audit and non-audit services (including, in the case of the latter, the nature and amount of each of the non-audit services provided by the auditor); and
 - a practice related to the auditor's firm for non-audit services provided in relation to the entity or economic entity (including the nature and amount of each category of non-audit service).

ABBREVIATIONS

The following abbreviations are used throughout this report:

AASB	Australian Accounting Standards Board
ANAO	Australian National Audit Office
AOSSG	Asian-Oceanian Standards Setters Group
APES	Accounting Professional and Ethical Standard
APESB	Accounting Professional and Ethical Standards Board
APPC	Australian Public Policy Committee
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
ATO	Australian Taxation Office
AUASB	Auditing and Assurance Standards Board
CALDB	Companies Auditors and Liquidators Disciplinary Board
Corporations Act	<i>Corporations Act 2001</i>
CPAAOB	Certified Public Accountants and Auditing Oversight Board (of Japan)
CPP	Certificate of Public Practice

ABBREVIATIONS (CONTINUED)

EC	European Commission
EU	European Union
FASB	Financial Accounting Standards Board (of the USA)
FRC	Financial Reporting Council
FRC-UK	Financial Reporting Council (of the UK)
FRSB	Financial Reporting Standards Board (of New Zealand)
FSA-UK	Financial Services Authority (of the UK)
FSA-J	Financial Services Agency (of Japan)
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
ISA	International Standard on Auditing
MOU	Memorandum of Understanding

ABBREVIATIONS (CONTINUED)

NIA	See IPA
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
RDR	Reduced Disclosure Regime
SEC	Securities and Exchange Commission (of the USA)
SEM	Single Economic Market
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)

AUSTRALIAN AUDITORS, AUDITORS, INDIVIDUAL AUDITORS, AUDIT FIRMS AND AUDIT COMPANIES

The ASIC and Corporations Acts use a number of terms to describe the individuals, firms and companies that may be appointed as auditor for a company or a registered scheme under Part 2M.4 of the Corporations Act.

The expression 'Australian auditor', which is used in Part 12 of the ASIC Act for setting the scope of the FRC's auditor independence function, is defined in section 5 of that Act to mean an individual auditor, an audit firm or an audit company.

In the Corporations Act, the terms 'individual auditor', 'audit firm' and 'audit company' are used to describe the manner in which the requirements of the Act apply to the different structures under which an audit practice may be conducted: sole trader, partnership and company.

For purposes of consistency and to simplify drafting, this report uses the expression **audit firm** to refer to all three structures.

