

Financial Reporting Council
Report on Auditor Independence
2006-07

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Australian Government

Financial Reporting Council

Chairman:

Mr Charles Macek
c/- The Treasury
Langton Crescent
Canberra ACT 2600

Telephone:

(03) 8621 2000

Email:

chairman@frc.gov.au

Secretariat:

c/- The Treasury
Langton Crescent
Canberra ACT 2600

Telephone:

(02) 6263 3144

Facsimile:

(02) 6263 2770

E-mail:

frcsecretary@treasury.gov.au

5 December 2007

The Hon Wayne Swan MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

I have pleasure in presenting the report of the Financial Reporting Council (FRC) on the performance of its auditor independence functions for the year ended 30 June 2007.

This is the third report prepared by the FRC in accordance with section 235BA of the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

Subsection 235BA(1) of the ASIC Act requires the FRC, by 31 October each year, 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. On 31 October 2007, the then Parliamentary Secretary to the Treasurer agreed, pursuant to subsection 235BA(2) of the ASIC Act, to an extension of time for the preparation of this report.

Under subsection 235BA(3) of the ASIC Act, the report must be tabled in each House of the Parliament as soon as practicable.

Yours sincerely

A handwritten signature in black ink, appearing to read 'C. Macek'.

Charles Macek

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ABBREVIATIONS

The following abbreviations are used throughout this report:

APESB	Accounting Professional and Ethical Standards Board
APRA	Australian Prudential Regulation Authority
AQRB	Audit Quality Review Board
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
ASX	Australian Securities Exchange Ltd
ASXMS	ASX Markets Supervision Pty Ltd
ATO	Australian Taxation Office
CALDB	Companies Auditors and Liquidators Disciplinary Board
CLERP	Corporate Law Economic Reform Programme
CLERP 9 Act	<i>Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004</i>
Corporations Act	<i>Corporations Act 2001</i>
CPA	CPA Australia
CPE	Continuing Professional Education
CPP	Certificate of Public Practice
EU	European Union
FRC	Financial Reporting Council
ICAA	The Institute of Chartered Accountants in Australia
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IOSCO	International Organization of Securities Commissions
MOU	Memorandum of Understanding
MOU bodies	APRA, ASIC, ASX, CPA, ICAA and NIA
NIA	National Institute of Accountants
PCAOB	Public Company Accounting Oversight Board (United States)
PPC	Public Practice Certificate
RCAs	Registered company auditors
SEC	Securities and Exchange Commission (United States)
SMSF	Self-Managed Superannuation Fund
UK	United Kingdom
US	United States of America

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.

CONTACT OFFICER

The contact officer for this report is the Financial Reporting Council Secretary, who may be contacted at:

Post: 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

1. EXECUTIVE SUMMARY

- This report outlines the work undertaken by the Financial Reporting Council (FRC) during 2006-07 in the performance of its auditor independence functions. The report also sets out the findings of the FRC as a result of that work and, where appropriate, the action taken by the FRC in respect of those findings.
- During the year the FRC addressed each of the core issues that, together, make up its auditor independence functions.
- The overall conclusion reached by the FRC as a result of its 2006-07 work on auditor independence is that the independence framework continues to operate effectively. No systemic issues were identified as a result of the work undertaken by the various parties. This outcome is consistent with the conclusions reached by the FRC in both 2004-05 and 2005-06.

Systems and processes of Australian auditors

- Since 1 July 2004, when the FRC first became responsible for monitoring auditor independence requirements, audit firms have made significant progress in the adoption and refinement of the systems and processes they use to ensure compliance with auditor independence requirements. The annual audit inspection programmes undertaken by the Australian Securities and Investments Commission (ASIC) initially focused on the major audit firms, with inspections in subsequent years reviewing the firms covered in the previous year and being progressively extended to cover other significant firms that conduct audits of publicly listed entities.
- In 2006-07, the FRC undertook its work on monitoring the systems and processes used by audit firms to ensure compliance with auditor independence requirements by gathering information from ASIC, reviewing reports published by the Audit Quality Review Board (AQRB) and The Institute of Chartered Accountants in Australia (ICAA) and through meetings with the four largest audit firms (the 'Big Four') and two other firms. In reaching the overall conclusion referred to above, the FRC noted:
 - ASIC's 2006-07 audit inspection programme covered nine firms in the group immediately below the Big Four firms, with five of these firms being reviewed for the first time. ASIC's report indicated that the four firms being reviewed for the second time made significant progress in addressing the observations and findings ASIC raised with them in 2005-06. In contrast, ASIC noted that some of the firms being reviewed for the first time had not taken a proactive approach to planning and implementing effective policies, systems and processes to ensure compliance with the legislative requirements for independence and audit quality.

- the AQRB's 2006 report which concluded that all of the Big Four firms have established policies and procedures that are designed to enable them to complete effective audits within the framework of current Australian legal and professional requirements.
- The ICAA also conducted a review of 32 firms which audited publicly listed companies. The ICAA found that the majority of reviewed firms are meeting independence standards with some minor breaches being noted. Based upon the experience of the firms being reviewed taking swift remedial action, and the recommendation for further training and awareness of independence requirements set out in this report, the FRC believes there is no evidence of a systemic problem in relation to auditor independence.
- As a result of the inspections by ASIC¹ and reviews by the AQRB² and the ICAA³, the FRC formed the view that the systems and processes used by audit firms to ensure compliance with independence requirements are working effectively. However, the FRC notes that the work by ASIC and the ICAA has revealed that some of the smaller firms covered by the respective inspections and reviews do not appear to have a thorough understanding of the legislative and professional requirements on auditor independence.
 - In these circumstances, the FRC believes that there would be merit in both ASIC and the professional accounting bodies having additional educative programmes targeted at audit firms. The FRC notes that at least one of the professional bodies, the ICAA, has already instituted a number of measures that are intended to improve its members' understanding of independence requirements.

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- 1 An ASIC inspection seeks to enhance public confidence in capital markets through raising the standard of audit quality and auditor independence in the profession. It is designed to assess the firm's overall audit quality, and its compliance with the independence requirements included in the *Corporations Act 2001*, auditing standards, and professional and ethical standards. An inspection includes reviews of documentation, interviews with partners and staff, limited testing and verification of systems and processes, and reviews of aspects of a sample of individual audit and review engagements for compliance with the firm's stated audit methodology and applicable auditing standards as at the date of each audit or review.
 - 2 The AQRB's current work is with the major firms and is 'to monitor and report on quality assurance processes ... in respect of financial statement audits of publicly listed entities in Australia.' The AQRB does not 'examine the merits of a particular audit, the conclusions reached or the appropriateness of the audit opinion other than as merely incidental to the review of the firm's processes and systems.' [AQRB *Report on 2006 reviews*, p 4].
 - 3 An ICAA review 'assesses the quality control policies and procedures in an accounting practice.' The reviewer 'examines manuals ... and selects a cross-section of current engagement files to assess whether quality control procedures are being implemented. [ICAA *Annual Report on the Quality Review Program for the year ended 30 June 2007*, p 11].

Activities of professional accounting bodies

- During this period, the FRC continued its work on monitoring and assessing the nature and overall adequacy of:
 - the systems and processes used by the professional accounting bodies for planning and performing quality assurance reviews of audit work undertaken by audit firms; and
 - the investigation and disciplinary procedures of the professional accounting bodies as those procedures apply to audit firms.
- In addition, the FRC also continued to monitor the adequacy of the teaching of ethics.
- Having regard to the in-depth reviews of these activities undertaken by consultants in 2005-06, the FRC restricted its work in 2006-07 to periodic meetings with the professional accounting bodies and reviewing publicly available material issued by them.
- The FRC notes that the professional bodies have in place continuing professional development programmes to ensure members are adequately informed about and conscious of the auditor independence requirements and that during the year the bodies conducted educational sessions on a number of audit-related topics.
- As a result of this work, the FRC did not become aware of any matters that would cause it to be concerned about the adequacy of the activities of the professional accounting bodies during 2006-07.

Consultants

- During 2006-07, the FRC arranged for two consultants to be engaged to undertake additional work flowing out of the three 2005-06 consultancies.
- The Allen Consulting Group reviewed a series of recommendations made in 2005-06 by consultants engaged to review the disciplinary procedures and quality review programmes of the professional accounting bodies. Allen Consulting, which undertook the review from a policy perspective rather than the compliance perspective of the original consultants, found that while a number of issues were raised that require further investigation, currently available evidence does not warrant specific change to the current regulatory framework as recommended in the two previous reports to the FRC. In these circumstances, Allen Consulting did not recommend any immediate change to the regulatory framework.

- Allen Consulting did, however, identify a number of areas for further investigation by the FRC, including that the FRC should examine the costs and benefits of particular aspects of the UK model that could improve the performance of the Australian regulatory framework. As the first stage of this process, the FRC proposes engaging a consultant during 2007-08 to undertake a mapping of the reporting supply chain, identifying all participants, their role, inter-relationships and the reward-punishment incentives which shape their behaviour.
- A summary of recommendations made by Allen Consulting is contained in section 3.2 of this report, with a full list appearing in Appendix D.
- Mr Richard Boele of The Banarra Trust (Banarra) undertook an evaluation of the way in which professional and business ethics are applied in practice by audit firms. Banarra found that ethical practices are highly valued within the accounting profession. Banarra also found that while it could not arrive at any clear conclusions in terms of ethics practice between the Big Four and the significant other firms, there were clear differences in practice between individual firms. A summary of the recommendations made by Banarra is contained in section 3.3 of this report while a more detailed outline of its findings and recommendations is contained in Appendix E.
- As part of its 2007-08 work programme, the FRC will be considering whether there is a need for it to make any recommendations to the Minister and the professional accounting bodies about issues arising out of the consultants' reports. To facilitate this process, the FRC will be publishing the Allen Consulting and Banarra reports as discussion papers on its website for the purpose of seeking feedback on the recommendations from stakeholders and other interested parties.

Comparative review

- In 2005-06 Australia's requirements on auditor independence were compared with the equivalent requirements applying in Canada, the European Union (EU), the United Kingdom (UK) and the United States of America (US). As a result of the review, the FRC identified a number of areas in which the Australian requirements differed from those applicable in the other jurisdictions.

- Following consultation with key stakeholders, the Government decided to amend those independence requirements dealing with the multiple former audit partner restriction, the former audit partner 'cooling-off' restriction, and adopt a 'covered person'⁴ approach in relation to the existing financial relationship restrictions.
- Legislation implementing these changes was enacted by the Australian Parliament during June 2007.

Other matters

- Information provided to the FRC by ASIC and the Australian Securities Exchange (ASX) shows that the majority of financial reports complied with the auditor-related disclosure requirements examined as part of the review. There were, however, a small number of financial reports that failed to comply with these disclosure requirements. One entity failed to include an auditor's independence declaration and there were minor exceptions in the declarations for two other entities. The directors' reports of five companies were identified as failing to disclose non-audit services where it appeared that such services were provided and/or did not include an unqualified statement that non-audit services had not affected the auditor's independence. As part of its 2007-08 work programme, the FRC will continue to review, and analyse, the level of compliance with audit-related disclosure requirements by considering the information provided by the bodies with which the FRC has signed a Memorandum of Understanding (MOU bodies).
- As part of its 2006-07 work programme, the FRC undertook some preliminary work on the quantum of fees for audit and non-audit services that were received by audit firms from their clients. The FRC's findings, which were based on a sample of 84 entities⁵, are outlined in section 3.4 of this report. In 2007-08, the FRC plans to continue its research into the quantum of fees received by auditors of audited entities for audit and non-audit services provided to those entities.
- During 2006-07 the FRC, in consultation with ASIC and the professional accounting bodies, reviewed the Register of Company Auditors to obtain statistical information about the professional affiliations of those auditors. The review was based on the register as at 14 November 2006, when a total of 5,815 individuals were registered.

4 The expression 'covered person' is used in the Securities and Exchange Commission (SEC) Rules to describe members of an audit firm who are subject to financial restrictions because of their involvement with an audit. During 2007 the Australian Government decided to adopt a 'covered person' approach to financial investment restrictions by limiting the restrictions to professional members of the audit team rather than all partners in the firm (as occurred at the time of the CLERP 9 reforms).

5 This information was provided by CGI Glass Lewis Pty Ltd and is used in this report with the permission of that firm. Any observations about, or conclusions drawn from, this information in this report reflect the views of the FRC and not CGI Glass Lewis.

The key finding from this work was that 87.8 per cent of registered company auditors were members of at least one of Australia's three professional accounting bodies. Inquiries by the FRC suggest that the 12.1 per cent of RCAs who were not identified as being members of a professional accounting body either are in the course of withdrawing from the profession or only perform small audits.

2. INTRODUCTION

Under section 225 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the FRC is responsible for monitoring the effectiveness of auditor independence requirements in Australia and giving the Minister reports and advice about those requirements. In addition, the FRC's functions include giving the professional accounting bodies reports and advice about aspects of their quality review programmes and disciplinary procedures. A summary of the FRC's auditor independence functions appears in Appendix A of this report.

The FRC has put in place a number of administrative arrangements designed to facilitate its performance of the auditor independence functions. These arrangements include:

- the establishment of an Audit Independence Committee, which deals with day-to-day matters associated with the performance of the function in consultation with the FRC's auditor independence consultant; and
- a programme of regular meetings, and the exchange of information, with the bodies with which the FRC has entered into MOUs and with selected audit firms.

More information about these arrangements, including the membership of the Committee and the names of the MOU bodies, is contained in Appendix B.

During 2006-07, the FRC continued to perform the auditor independence functions in a manner broadly similar to the way in which the functions were performed in 2004-05 and 2005-06. In 2006-07, the FRC's work addressed each of the core issues that comprise these functions: systems and processes of audit firms, quality review programmes and disciplinary procedures of the professional accounting bodies, the teaching of ethics by, or on behalf of, those bodies and compliance by companies with audit-related disclosure requirements.

The auditor independence work performed by the FRC during the period under review, including the findings and conclusions reached by the FRC in the performance of its functions and the actions (if any) that it took, is described in later sections of this report. Appendix F lists the key matters arising from the 2005-06 independence report and the action that was taken by the FRC in respect of each of those matters during 2006-07.

AUDITOR INDEPENDENCE SINCE 2004-05 — A REVIEW

The FRC's functions were significantly expanded from 1 July 2004, when the comprehensive package of audit reforms contained in the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9 Act) came into operation. The expanded functions include monitoring the effectiveness of audit

independence requirements in Australia and giving the Minister reports and advice about those requirements.

The FRC, through its Audit Independence Committee, has now conducted its work for three years and has issued a report for each of the three years (including this year's report). This section overviews the FRC's findings over these three years and makes recommendations, based upon its observations and findings, as to the way forward.

In the first year, 2004-05, the FRC's main focus was on the systems adopted by the four major firms that dominate the audits of publicly listed entities. Meetings and discussions were also held with the MOU parties to assess how they were adopting and adapting to the new requirements. The overall conclusions were positive:

- There was an open approach to the significant changes required by CLERP 9 by all of the MOU bodies and the major audit firms. The 'tone at the top' regarding independence at all these bodies was positive.
- The major audit firms had significantly upgraded their systems, quality control, training and disciplinary processes. These firms had different approaches to some of these issues but all complied with the level required by CLERP 9.
- The regulators had updated their processes to monitor compliance with CLERP 9 and in the case of ASIC had completed their first round of visits to the major audit firms.
- The ICAA had reviewed its monitoring of the major audit firms. Whilst not performing any reviews of the major continuing audit firms since 2002, the ICAA would ensure that reviews were done in 2005-06.⁶
- The need for the auditing profession to have a clear public interest focus in its activities should be reinforced. Public trust in the profession is heavily influenced by perception of its actions, which needs to be taken into account by the profession in its conduct. This is a key component of the strategic direction that the FRC has given to the AUASB with respect to its auditing standard setting activities and is an area that we will continue to monitor closely.
- Audit firms need to ensure that the appropriate 'tone at the top' is reflected in a strong message conveyed to staff on the importance of adherence to their own systems and processes, including attendance at training on audit independence requirements.

Some minor unintended consequences of the technical amendments included in the CLERP 9 legislation were identified by the various stakeholders and processes were

6 ICAA reviews of the major audit firms are conducted on a three year cycle and no reviews of these firms were scheduled for 2004-05. The ICAA has informed the FRC that its reviews of the major firms were undertaken in 2005-06 and 2006-07.

started to address those issues. These processes were completed during 2006-07 with the enactment of the Simpler Regulatory System Bill.

In 2005-06, the FRC's work on auditor independence was conducted building largely on the work of the first year. ASIC again conducted a review of the four major firms and extended its review to six⁷ other firms with significant audit practices. The scope of ASIC's inspections in 2005-06 was similar for both the Big Four and other firms and included both independence and audit quality. A summary of ASIC's report to the FRC noted that:

- the firms had generally responded positively to the new Australian legislative requirements for auditor independence and auditor quality; and
- its observations and findings varied considerably between the Big Four firms and the other firms, as the challenges faced by these respective firms and the resources available to them were significantly different.

ASIC's report contained the following comments concerning independence at the Big Four firms:

- all the firms had the resources and capability to undertake audits of the largest listed entities and the necessary resources to implement effective systems in response to changes to the regulatory framework;
- ASIC recognised that the firms had had limited time since the completion of the first-year inspections to implement all of its observations and findings; and
- while the necessary improvements could be characterised as further enhancements to an already fundamentally sound process, there was a need for further improvements in the quality of audit work done on the financial statements of listed entities in Australia, with areas requiring continued emphasis from the leadership of the Big Four firms including:
 - compliance with their independence policies; and
 - documentation and approval of non-audit services.

In respect of the other firms, ASIC noted that its observations and findings varied considerably between the firms. It acknowledged that there were significant differences in the other firms' size, structural complexity, extent of centralised resources and international reach. Accordingly, it stated that its observations for the

7 Only four of these firms are included in the second-year reviews included in ASIC's 2006-07 audit inspection programme report. The inspection of a fifth firm was still in progress at the deadline for the preparation of the ASIC report for the FRC, while the sixth firm had merged with a Big Four firm and is incorporated in ASIC's inspection of the latter firm.

firms visited might not be indicative of this group of firms as a whole, or of other member firms of the associations to which they belong.

In 2006-07 the FRC's work again built upon the work of the first two years. ASIC is in the process of reviewing the four major firms but at the date of this report has not issued its report covering these firms. The Big Four firms were reviewed by the AQRB for the period to December 2006 and the AQRB in its report in September 2007, which is summarised in section 3.1 of this paper, issued positive findings in respect of its reviews of these firms.

ASIC reviewed four other firms for the second time and five other firms for the first time. Details of the ASIC findings are also set out in section 3.1 of this report. With respect to the firms being reviewed for the second time, major issues have been addressed and good progress was noted in most areas. With regard to the firms reviewed for the first time, ASIC remarked that many firms need to take action to bring their independence policies into line with the requirements of the Corporations Act. In addition, ASIC has informed the FRC that its inspection work highlighted the need for two of the other firms to address the rotation requirements as a matter of urgency to ensure compliance with the Corporations Act.

The ICAA also conducted a review of 32 firms which audited publicly listed companies. The ICAA found that the majority of reviewed practices are meeting independence standards, with some minor breaches noted as set out in section 3.2 of this report. Based upon the experience of the firms being reviewed taking swift remedial action, and the recommendation for further training and awareness set out in this report, the FRC believes there is no evidence of a systemic problem in relation to auditor independence.

The FRC, as stated above, has now conducted its work and issued its report for three years. The profession has embraced the requirements of CLERP 9 in terms of clearly demonstrating the right tone at the top, and the firms that audit the vast majority of listed entities have invested heavily in the systems and processes that allow them to comply with CLERP 9. ASIC, the AQRB and the professional accounting bodies have also invested considerable resources into ensuring that audit firms are complying with the Act and, with the exception of some of the smaller audit firms that audit a small percentage of listed companies, are satisfied that independence requirements are being followed. Except as mentioned above, during this period no serious independence breaches have been brought to the attention of the FRC.

Given the Government's aim of reducing red tape and the regulatory burden on business, the FRC believes that the co-regulatory reviews for ensuring compliance with auditor independence requirements, which were so crucial in the three years following the commencement of the CLERP 9 legislation and the enhanced professional requirements, should be streamlined. While the primary role of ASIC in reviewing the audit firms is acknowledged, the FRC encourages ASIC, the AQRB and the professional accounting bodies to continue to work together to streamline their review processes and reduce the regulatory burden on the audit firms whilst still ensuring

that CLERP 9 is being complied with. The objective would be to reduce the compliance costs which are inevitably passed on to the companies being audited.

In conducting their reviews, ASIC, the AQRB and the accounting bodies have focused on the firms' procedures for approving non-audit services. The FRC has obtained information about audit and non-audit fees paid or payable to the auditors of 84 entities, the majority of which are included in the S&P/ASX 100 index. The FRC's preliminary observations include that:

- fees for audit services represented more than 75 per cent of the total fees of the auditors of 43 entities, while the fees for these services for a further 28 entities were between 50 and 75 per cent of the total fees of their auditors;
- fees for audit and audit-related services represented more than 75 per cent of the total fees of the auditors of 55 entities, while the fees for these services for a further 20 entities were between 50 and 75 per cent of the total fees of their auditors;
- fees for other services represented more than 25 per cent of the total fees of the auditors of 10 entities (including, in the case of two of these entities, more than 50 per cent of their auditors' total fees);
- fees for taxation services represented more than 25 per cent of the total fees of the auditors of 12 entities (including, in the case of two of these entities, one each in the ranges 50 to 75 per cent and over 75 per cent).

The quantum of non-audit fees versus audit fees in respect of some of the entities reviewed appears to be quite substantial. The ASX, which also has an interest in this matter, has informed the FRC that it does not analyse the information about remuneration of auditors that is included in annual reports of listed entities except to ensure that the disclosure is made in accordance with the legal requirements.

One of the main drivers for change that led to CLERP 9 being passed was a view that in some instances the non-audit services provided by the auditing firm could impede its independence. The FRC is also aware that some of the major firms are expanding their consultancy services now that the non-compete clauses with the purchasers of their consultancy practices some five or more years ago have begun to expire. In contrast to the comments regarding the extent of review of independence being reduced and streamlined for the auditing firms, the FRC is of the view that the provision of audit services versus non-audit services needs to be considered further to ensure that there is no systemic problem. This exercise, whilst looking at the services in monetary terms, will focus on the nature of the work to ascertain whether it may impede auditor independence, and is on the FRC's work programme for 2007-08.

In concluding this review of auditor independence since 2004-05, there is one systemic issue which the FRC believes needs to be kept under review: concentration of audit amongst the Big Four, which collectively audit approximately 88 per cent by

composition and 96 per cent by market capitalisation of the 300 largest entities listed on the ASX.⁸ The concentration of audit is an issue about which the UK FRC has been undertaking research and which the International Forum of Independent Audit Regulators (IFIAR) is monitoring and discussing. Anecdotal evidence noted by the FRC suggests that national audit regulators, in adopting a common regulatory regime for all firms irrespective of their size and business models may have contributed to the concentration of audit business in the largest firms. The smaller firms, while often having fewer resources than the larger firms, operate in an environment in which their partners are closer to each other and to their clients than may be the case with the largest firms. Consequently, while compliance with the law and regulations is not negotiable, the FRC believes that the manner in which this is achieved could vary between firms of different sizes.⁹

FUTURE WORK PROGRAMME

For the immediate future it is envisaged that the FRC's auditor independence function work programme will continue the work undertaken by the FRC during the last three years.

In addition to undertaking the ongoing work associated with monitoring and assessing the nature and overall adequacy of the systems and processes used by Australian auditors to ensure compliance with auditor independence requirements, the FRC will also seek to consolidate its work on the quality review programmes and disciplinary procedures of the professional accounting bodies and the teaching of ethics by, or on behalf of, those bodies.

A detailed outline of the work programme for 2007-08 is contained in Appendix G of this report.

8 AQRB report on 2006 review, p 3.

9 ASIC has advised the FRC that ASIC's inspection process is tailored to reflect differences between firms in relation to size, structural complexity, extent of centralised resources, and international reach, among other factors. However, legal requirements are common to all firms and it is ASIC's expectation that all firms will comply with their legal obligations.

3. AUDITOR INDEPENDENCE IN AUSTRALIA

Australia has comprehensive legislative and professional requirements concerning the independence of auditors. The principal requirements are:

- Division 3 of Part 2M.4 of the Corporations Act which sets 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 audits of historical financial information*, which was issued by the Auditing and Assurance Standards Board in April 2006;
- Section 290 of APES 110 *Code of Ethics for Professional Accountants*, which was issued by the Australian Accounting Professional and Ethical Standards Board (APESB) in June 2006;
- APES 320 *Quality control for firms*, which was issued by the APESB in May 2006.

CORPORATIONS ACT REQUIREMENTS

Under the Corporations Act, all disclosing entities, public companies, large proprietary companies 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.

ASIC may, in certain circumstances, relieve a large proprietary company of the obligation to have its financial report audited. On the other hand, the members of a small proprietary company that is not required by the legislation to prepare a financial report can require the company to prepare such a report and have it audited.

In 2004, amendments made to the Corporations Act by the CLERP 9 Act established a comprehensive regime on auditor independence. As a result of these amendments, which implemented recommendations of the Ramsay report (*Independence of Australian Company Auditors*) and relevant recommendations of the HHH Royal Commission, the Corporations Act contained the following measures to promote auditor independence during 2006-07:

- a general requirement of auditor independence;
- a requirement that auditors provide directors with an annual independence declaration;
- a prohibition of a number of specific employment and financial relationships between auditors and their clients which are considered to compromise independence;

- a 'cooling-off' period of two years for partners of an audit firm who are directly involved in the audit of an audit client before they can take up a directorship or senior management position with an audit client;
- consistent with the recommendations of the HIH Royal Commission, a restriction on more than one former audit firm partner becoming an officer of an audit client at any one time;
- a requirement for an auditor of a listed company to attend the company's annual general meeting, and for shareholders to be able to submit written questions to the auditor concerning the auditor's report, including the independence of the auditor;
- a requirement for audit partner rotation for auditors of listed companies after five consecutive years. ASIC has limited relief powers to modify the rotation requirements where they would impose an unreasonable burden on the auditor or audited body; and
- a requirement for listed companies to disclose in their annual directors' report the fees paid to the auditor for each non-audit service, together with a description of the service. In addition, the annual directors' report of each listed company must include a statement by directors that they are satisfied that the provision of non-audit services does not compromise the auditor's independence.

During 2006-07, the Government made a number of changes to the auditor independence requirements as part of the package of reforms contained in the Simpler Regulatory System legislation.¹⁰ These amendments:

- addressed a number of anomalies and unintended consequences that were identified during the implementation of the CLERP 9 auditor independence requirements and were initially remedied by amendments to the Corporations Regulations or ASIC class orders. Further information about these amendments is included in section 3.5 of this report under 'issues associated with the CLERP 9 reforms';
- implemented refinements to the multiple former audit firm partner restriction, the former audit partner 'cooling-off' restriction and the adoption of a 'covered person' approach in relation to the existing financial relationship restrictions identified as a result of a comparative review of Australia's auditor independence requirements. Additional information about these amendments appears in section 4 of this report under 'comparative review of Australian requirements'.

¹⁰ *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007.*

ENSURING COMPLIANCE WITH REQUIREMENTS

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, and their respective roles, are listed below.

Australian Securities and Investments Commission

ASIC is the body that registers company auditors in Australia. To become a registered company auditor, an applicant must satisfy ASIC as to their qualifications, experience and competency in auditing.

ASIC conducts inspections of audit firms to assess their compliance with the audit requirements of the Corporations Act and auditing standards, including audit independence provisions.

Australian Securities Exchange

The ASX is required under the Corporations Act to ensure that the listed company markets are fair, orderly and transparent. Since 1 July 2006, the key supervisory operations of the ASX have been undertaken by ASX Markets Supervision Pty Ltd (ASXMS), a subsidiary company under a charter to undertake principles-based market supervision. ASXMS is responsible for monitoring the conduct of market users and compliance with ASX Operating Rules, enforcing the Operating Rules, and ensuring that sufficient resources are allocated to it to perform its supervisory functions.

The ASX Corporate Governance Council principles recommend that an audit committee should oversee the appointment of auditors and their independence of listed companies. ASX Principle 4: 'Safeguard integrity in financial reporting' requires the company to have a structure that independently verifies and safeguards the integrity of the company's financial reporting. This would include, for example, a review and consideration of the accounts by the audit committee, and a process to ensure the independence and competence of the company's external auditors.

A declaration of compliance with the auditor independence requirements under section 307C of the Corporations Act or of any applicable code of professional conduct in relation to the audit must be made by the auditor and be included in the directors' report. The ASX monitors compliance with auditor independence certificate requirements and advises ASIC of any breaches.

Professional accounting bodies

The professional accounting bodies (the ICAA, CPA Australia and the NIA) undertake regular mandatory quality reviews of members who have a Certificate of Public Practice (CPP) or Public Practice Certificate (PPC). The reviews include ensuring their members are complying with the accounting, auditing and assurance standards and the code of ethics issued by the APESB. The reviews take place on a rolling three-year programme for auditors of listed entities.

The Audit Quality Review Board (AQRB) monitors firms that audit publicly listed companies (currently its role is limited to the Big Four firms) to assess whether they comply with professional standards and the law.

Each of the professional accounting bodies has entered into a Memorandum of Understanding with the AQRB under which they share information where appropriate, consult regularly and promote discussion on issues such as quality control and independence in the auditing of publicly listed companies. Since June 2007, the AQRB has been represented on the ICAA's Quality Review Committee.

Accounting Professional and Ethical Standards Board

The APESB was established in February 2006 by the ICAA and CPA Australia as an independent body to set the code of ethics and the professional standards by which their members are required to abide. The NIA has subsequently become a member of the APESB.

Audit Quality Review Board

The AQRB is a not-for-profit company limited by guarantee that was established in December 2005 at the initiative of, and with the commitment of, the four largest accounting firms, to act as an independent review body. The AQRB, which is chaired by Professor the Hon Andrew Rogers QC, has up to 10 members who have broad knowledge and experience in legal, regulatory, business and auditing affairs.

The Board has established a Constitution, Code of Conduct and Rules, which provide the framework for its operations.

The initial participants in the AQRB's review programme are the four largest accounting firms, which audit collectively 88 per cent by composition and 96 per cent by market capitalisation of the 300 largest listed entities on the ASX. Participation in the programme is voluntary and available to all Australian audit firms which audit listed companies.

The AQRB's primary purpose is to monitor the processes by which participating audit firms seek to ensure their compliance with applicable professional standards and legal

obligations in relation to independence and audit quality with respect to financial statement audits of publicly listed entities. In its 2007 reviews the AQRB has expanded its scope to cover 'public listed entities', which it has defined as public listed entities, unlisted disclosing entities, APRA regulated bodies and large proprietary companies (as defined in the Corporations Act).

The AQRB has stated that it aims to enhance the credibility and integrity of the Australian auditing framework, to improve public confidence in that framework and to contribute to the continual improvement of the audit profession for the benefit of the Australian public.

Companies Auditors and Liquidators Disciplinary Board

The CALDB, which is established under the ASIC Act, may take disciplinary action on the application of ASIC or the Australian Prudential Regulation Authority (APRA) against an auditor or liquidator. The CALDB has power to admonish or reprimand a person; require a person to give an undertaking to engage in, or to refrain from engaging in, specified conduct; require a person to give an undertaking to refrain from engaging in specified conduct except on specified conditions; and suspend or cancel a person's registration. The CALDB does not have the power to initiate disciplinary actions on its own.

Financial Reporting Council

Since July 2004, the FRC has been responsible for monitoring the effectiveness of auditor independence requirements in Australia and giving the Minister reports and advice about those requirements. The FRC has been given information gathering powers to support its auditor independence monitoring role.

3.1 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.

In 2006-07, 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 Audit Quality Review Board (AQRB) and through meetings with the four largest and two other audit firms.

As a result of this work, the FRC formed the view that the systems and processes used by audit firms to ensure compliance with independence requirements are working effectively. However, the FRC notes that inspections by ASIC and reviews by the ICAA (see section 3.2 below) have revealed that some of the smaller firms covered by the respective inspections and reviews do not appear to have a thorough understanding of the legislative and professional requirements on auditor independence.

The FRC believes that there would be merit in both ASIC and the professional accounting bodies having appropriate educative programmes targeted at auditors. The FRC notes that at least one of the professional bodies, the ICAA, has already instituted a number of measures that are intended to improve members' understanding of independence requirements.

REPORT FROM ASIC

The MOU that the FRC has entered into with ASIC provides for periodic consultations and information sharing between the two bodies to assist in undertaking their respective responsibilities under the law.

ASIC's third report to the FRC on the audit inspection programme describes ASIC's inspection process together with its observations and findings in relation to the independence systems and audit quality of selected firms where inspections commenced after July 2006 and were completed prior to 30 June 2007. As at 30 June 2007, ASIC's inspection process had commenced at the four largest audit firms, but had not been completed. Accordingly its report does not include the results of any of the inspection work performed at these firms in the year ended 30 June 2007, or the results of any ongoing inspection work at other firms.

As in past years, the review undertaken by ASIC has constituted a key source of information for the FRC with respect to its responsibilities in this area during 2006-07.

ASIC's inspection process for the year ended 30 June 2007 covered nine selected firms, five of which were being reviewed for the first time. The reviews were:

- first-year inspections of PKF Melbourne, Stanton Partners and Stantons International Perth, Grant Thornton South Australian Partnership, Pitcher Partners Brisbane and Lewis & Coble/Blackett & Lewis; and
- second-year (follow-up) inspections of BDO Sydney, PKF Sydney, Grant Thornton Western Australian Partnership and Pitcher Partners Melbourne.

Collectively, these firms audit approximately 3 per cent by composition and 0.6 per cent by market capitalisation of the 300 largest entities listed on the Australian Securities Exchange (S&P/ASX 300).

ASIC stated in its report that its observations and findings varied between the firms. It noted that there are marked differences in the firms' size, extent of centralised resources and international connections. Having regard to these observations, ASIC expressed the view that its general findings for the firms visited may not be indicative of other firms, including other member firms of the associations to which the firms belong.

The FRC is pleased to note ASIC's observation that the firms have generally responded positively to the amended legislative requirements for auditor independence and audit quality. The FRC commends those firms that have committed additional resources and have further developed existing policies and systems to assist them in complying with legislative requirements.

ASIC reported that the four firms being reviewed for the second time made significant progress in addressing the issues raised with them in 2005-06. Major issues had been addressed and good progress was noted in most areas.

In contrast, ASIC noted that some of the firms being reviewed for the first time have not taken a proactive approach to planning and implementing effective policies, systems and processes to ensure compliance with the legislative requirements for independence and audit quality. This lack of action on the part of some firms is of concern to both ASIC and the FRC, given:

- the legislative requirements have been in effect for three years;
- ASIC has issued two public reports on the results of its inspection process, identifying common observations and findings which all firms should have considered and proactively acted upon; and
- ASIC had previously visited another member firm of the association to which these firms belong in all but two cases.

ASIC's inspections of the smaller firms being reviewed for the first time identified that:

- many firms still need to take action to bring their independence policies into line with the requirements of the Corporations Act;
- most firms have yet to commence testing of their independence systems, including the provision of non-audit services, on a sample basis, to monitor compliance with the Act. Firms can place only limited reliance on the effectiveness of independence systems and processes without introducing an effective testing programme;
- most firms do not have adequate documentation supporting decisions to provide non-audit services to audit clients. Some firms did not have a documented policy dealing with the provision of non-audit services to audit clients to ensure non-audit services comply with the independence requirements in the Act and the APESB standard APES 110 *Code of Ethics for Professional Accountants*;
- in most firms, partner performance reviews are either not conducted or not documented, making it difficult to render partners accountable for non-compliance with audit quality and auditor independence policies and procedures;
- in some firms, criteria for the remuneration of audit partners do not explicitly include audit independence and audit quality;
- at the time of its inspections, most firms were in the process of mapping their audit manuals and related audit software programme steps to the legally enforceable auditing standards applicable to 31 December 2006 interim financial reports and 30 June 2007 financial reports. In some instances where firms were utilising external proprietary software, ASIC identified a number of areas where the requirements of recently revised Auditing Standards were not incorporated into the firms' auditing manuals or work programmes.

As part of its 2006-07 inspection programme, ASIC examined the processes in place at firms to ensure compliance with the auditor rotation provisions. ASIC has informed the FRC that, while most firms visited had robust processes in place to manage auditor rotation, there was a need for two firms to address the rotation requirements as a matter of urgency to ensure compliance with the Act.

The FRC interviewed two firms which were subject to the ASIC review. The firms were pleased that as far as possible ASIC tried to have continuity of staff on the review and the firms felt that the work was properly conducted. In similar vein to the FRC's meetings with the major firms, these other firms all offered views on how the system could be streamlined and this is commented on elsewhere in the report.

Staffing for ASIC is an issue as it is for all of the auditing firms; however, in our discussions ASIC advised that it was managing to recruit and retain the appropriate staff to fulfil its mandate.

REVIEWS BY THE AQRB

The AQRB reviewed each of the Big Four accounting firms during 2006 and published a public version of the report on each review¹¹ in early 2007. Subsequently, in September 2007, the AQRB published a report summarising the results of its 2006 reviews, which considered issues associated with audit quality as well as auditor independence.

Prior to conducting its reviews, the AQRB sought to gain an understanding of the processes and findings of overseas review organisations, in particular those operating in the US, the UK and Canada. In its report, the AQRB remarked upon the commonality of its key findings and those that were reported by most of the overseas review bodies.

The AQRB concluded, as a result of its reviews, that all of the Big Four firms have established policies and procedures that are designed to enable them to complete effective audits within the framework of current Australian legal and professional requirements.

In its summary report, the AQRB made the following observations about the commitment of the firms to the present auditing environment:

- The leadership of all four firms has taken a strong lead endorsing the importance of adherence to the new legislative and professional requirements. The AQRB noted that this commitment is evident in the firms' organisation-wide messages of support for the significantly enhanced resources that each firm has committed to quality and risk management.
- All firms have invested heavily to establish policies, systems and procedures to ensure compliance with new legislation and audit standards. The AQRB reported, however, that at some firms these new tools and systems suffer from a lack of integration and, consequently, are not as easy to use as the firms would wish. It indicated that the firms have programmes of enhancement in place to eliminate these problems.
- The new independence standards and provisions of the Corporations Act have required considerable investment in personnel and monitoring systems. The AQRB was impressed with the commitment to embed these requirements, and the understanding of them, within each firm.

A telling comment in the AQRB's summary report is that 'no other area of the firms' activities has received more attention, both internal and external, than their processes for ensuring that they remain independent of their audit clients and compliant with the law and professional standards'. The report also contained the following additional observations about auditor independence and threats to independence:

11 These reports may be viewed on the AQRB's website at www.aqrb.org.au.

- All firms have invested heavily in this area in terms of personnel and automated systems. Some firms started on this journey somewhat earlier than others and consequently have better developed automated systems than those who commenced later.
- All of the firms' monitoring systems have identified breaches (generally minor in nature) of their internal rules for independence which typically set a higher standard than required by regulation. The AQRB noted that these breaches can be worrying as they indicate a potential for breach of the legal requirements.
- All but one firm have policies and systems which require engagement-level independence confirmations from all staff employed on each engagement. The fourth firm relies on its other independence policies, processes and systems.

The AQRB has also made the observation that if independence requirements do not contribute to achieving objectivity in a real sense, they become costly and unnecessary overheads. The FRC elsewhere in this report has reflected upon whether the pendulum has swung too far in terms of the emphasis on audit independence and questions whether, now that more than three years has passed with only minor findings, the regulatory oversight can be somewhat ameliorated. The FRC encourages the AQRB, ASIC and the ICAA to continue to work together to streamline the process and reduce the regulatory burden on the auditing profession whilst still ensuring the regulations are being complied with.

The FRC is pleased to note the AQRB's positive findings in respect of the auditor independence issues considered as part of the AQRB's 2006 reviews of the Big Four accounting firms. The findings regarding audit independence are encouraging for the FRC and mirror the findings of ASIC and the ICAA in previous years. Three of the Big Four firms commented that they felt that the work by the AQRB reviewers had helped them improve their business practices due to the experienced former practitioners typically involved in undertaking these reviews.

MEETINGS WITH AUDIT FIRMS

During 2006-07 the FRC met with the four major accounting firms and two other firms with auditing practices. The issues discussed at these meetings are outlined below.

- Concentration risk: a number of parties referred to the concentration risk arising from there just being four extremely dominant auditing firms. There were concerns about the legislative regime favouring the big firms, with suggestions that smaller and some medium-sized firms may find it harder to comply with the legislative requirements, with the result that listed entities are moving away from using these firms as auditors. It was noted by some of the other firms that the Big Four had on occasions used the ASIC criticisms in its 2005-06 report against them in the tender process. Possible solutions suggested by some parties were that the CLERP 9 requirements should apply only to, say, the top 300/500 listed entities.

- People issues: people issues and challenges were remarked upon by most parties. The regulatory framework was cited as making the profession less attractive and making it hard for the major firms to recruit suitable personnel. Problems in recruiting become worse for the medium and smaller firms. The challenge in Western Australia, where many of the mining firms are based, was seen to be extreme. Some commentators are also concerned that the profession may be lowering its standards to provide the necessary manpower.
- Streamlining the review processes between the parties: discussions were held with a number of participants as to how after three years the co-regulatory processes for audit inspections and reviews could be streamlined. All parties accepted that ASIC will undertake whatever work it deems necessary in order to comply with its statutory obligations, but wondered whether the FRC should be encouraging continued collaboration between ASIC, the AQRB and the ICAA to streamline the processes. Areas that could be explored include whether: (a) where more than one party will be looking at the same area, the information formatting could be agreed in advance by the reviewing parties so that it is only prepared once; and (b) where both ASIC and either the AQRB or ICAA intend to review a firm, there could be some cooperative scheduling agreed well in advance. This is particularly relevant in view of the resource constraints and shorter reporting timeframes required by ASX. We were informed that roundtables have been held in the US and Europe with affected parties to discuss how all participants can leverage off the various reviews. The FRC strongly encourages all parties to consider these initiatives seriously and work in a cooperative manner.
- Preparation for CLERP 9: The ASIC review revealed that some of the smaller firms reviewed were ill prepared for the CLERP requirements review. The FRC agrees with ASIC that the level of preparedness of some firms is disappointing and would encourage the accounting bodies to run further education or focus groups for their members to help them comply with the legislative requirements. The FRC considers that focus group sessions would be most valuable for those firms that are based outside of Sydney and Melbourne.
- Expansion of non-audit services: A number of the major firms, which sold their consulting practices some five years ago, are now rebuilding their practices in specialist areas. The fees being generated by these non-audit services are growing strongly. This trend is one which the FRC will monitor in 2007-08 to ensure that offering these services does not cause audit independence issues.
- Trusts as a business structure versus companies: One of the national audit firms observed that the Australian corporate landscape and history lead to many businesses trading as trusts rather than as companies. The firm remarked that the emphasis of the regulatory bodies and the FRC is presently directed towards entities operating in the corporate regulatory environment. This is an issue that will be further considered by the FRC's Audit Independence Committee in 2007-08.

3.2 QUALITY REVIEW PROGRAMMES AND DISCIPLINARY PROCEDURES OF THE PROFESSIONAL ACCOUNTING BODIES

Under the ASIC Act, the FRC is required to monitor and assess the nature and overall adequacy 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 and subsequent follow-up actions by both auditors subject to such reviews and the professional bodies. 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.

In light of the reviews of the quality review programmes and disciplinary procedures of the professional accounting bodies undertaken by consultants in 2005-06, the FRC confined its work in this area during 2006-07 to obtaining relevant information at periodic meetings with the professional accounting bodies and to reviewing publicly available material issued by those bodies.

This information included the ICAA's annual report on its quality review programme for the year ended 30 June 2007. The report summarises the results of 478 reviews, of which 32 were practices that audit publicly listed companies. As at 30 June 2007, a further 518 practices were under review including 16 that audit publicly listed companies.

Independence compliance formed only a part of the ICAA reviews. It is pleasing to the FRC that the ICAA found that the majority of reviewed practices are meeting independence standards. The Institute did note the following breaches:

- Some members were auditing the self-managed superannuation fund (SMSF) of a partner in their practice or the fund of a close family member. In other cases, employees were auditing the superannuation fund of a partner in the firm.
- Some practices did not appear to have policies and procedures in place on assurance engagement requiring documentation of threats to independence and any related safeguards in accordance with APES 110 *Code of Ethics for Professional Accountants*.

To address these issues, the ICAA continued to promote its online education guide designed to assist auditors who perform audits of SMSFs. It also conducted related training seminars across Australia, and will be updating its guidance on independence in 2007-08.

The ICAA's findings about independence are not as critical as ASIC's as far as the smaller firms are concerned but reinforce ASIC's conclusion that after three years of

CLERP 9 being in force, some of the firms should be better prepared to comply with the legislative requirements. The FRC is pleased that independence has continued to be a focus of the ICAA over the last twelve months. Initiatives of the ICAA have included:

- updating the ICAA's Independence Guide: Interpretations in a co-regulatory environment, which explains the requirements of the code of ethics contained in APES 110 *Code of Ethics for Professional Accountants, Section 290 – Independence Assurance Engagements*, and gives practical examples of issues faced by accountants and auditors;
- updating an auditor independence checklist identifying relationships which may lead to independence issues in terms of the Corporations Act;
- regular commentary about independence in *Charter*, the ICAA's magazine.

Each of these initiatives has been promoted to members through member events, online newsletters, the ICAA's website and by quality reviewers themselves.

In its report, the ICAA acknowledges the need to assess and, if appropriate, place reliance on reviews by other bodies, such as the AQRB, to avoid duplication and minimise disruptions and costs to practices. The FRC encourages these initiatives and would also encourage the ICAA and ASIC to agree on other initiatives to streamline the process as set out in section 2.

As a result of this work, the FRC did not become aware of any matters that would cause it to conclude that there were deficiencies in either the systems and processes used by the bodies for planning and performing quality reviews of audit work, or the overall adequacy of the ICAA's investigation and disciplinary procedures.

Research by the FRC

During April 2006, the Treasury, in consultation with the FRC, engaged consultants to review the quality review programmes and disciplinary procedures of the professional accounting bodies. Messrs Graeme MacMillan and Michael Cain of CiptaNet International Pty Ltd examined the bodies' quality review programmes while Mr William J Bartlett examined their disciplinary procedures. A summary of the findings and recommendations made by each of the consultants was published in the FRC's *Report on Auditor Independence 2005-06*.

In its 2005-06 report, the FRC indicated that it intended to examine the findings and recommendations of the consultants as part of its 2006-07 work programme. Following preliminary consideration of the consultants' findings and recommendations and feedback that had been received by the FRC from its stakeholder bodies, the Council concluded that the recommendations should be reviewed to ensure they:

- clearly identify the need for a change to current policies, procedures or regulations by the professional accounting bodies, the Government or other stakeholders in order to better meet stated policy objectives in an efficient and effective manner;
- establish, when Government intervention is recommended, a policy rationale for the proposed intervention which is consistent with the Government's legislative and policy frameworks; and
- include consideration and assessment of alternative means to meet the stated policy objectives.

To undertake this project for the FRC, the Treasury engaged The Allen Consulting Group Pty Ltd. The key requirements of the statement of work for this consultancy are set out in Appendix D of this report.

In its report, Allen Consulting found that, while a number of issues were raised that require further investigation, currently available evidence does not warrant specific change to the current regulatory framework as recommended in the two previous reports to the FRC. In these circumstances, Allen Consulting did not recommend any immediate change to the regulatory framework. Allen Consulting did, however, identify a number of areas for further investigation by the FRC and these are listed below:

- Analysing market confidence in auditor independence: that the FRC sponsor:
 - a stakeholder mapping of different segments of users of audited financial information; and
 - a survey of stakeholder confidence that company-issued audited financial reports reflect actual business performance, the basis for this confidence, the confidence in the auditor's independence from the company's interests, stakeholders' view of any gap in confidence relative to the optimal level, and the level of understanding of the existing regulatory framework for auditor independence.
- Market understanding of the regulatory framework: that an information programme be undertaken to improve the understanding of the current regulatory framework, explain the specific roles of the various parties and the inter-relationships between these parties, and focus on improving the understanding within the profession of the roles of ASIC and the CALDB and their statutory requirements in fulfilling those roles.
- Coverage of registered company auditors (RCAs): that the FRC recommend that Government collect information on the number and nature of the audits undertaken by the 13 per cent of RCAs who are active and do not have membership with any of the professional accounting bodies, and the professional development training they undertake.

- Efficiencies in quality review effort: that the FRC recommend that key stakeholders review the resources, scope and outcomes of all quality reviews undertaken to identify any opportunities to reduce the review burden on audit firms whilst maintaining an acceptable level of market confidence in auditor independence.
- Enabling FRC's quality review monitoring: that the FRC formally request that each professional accounting body seek consent from each of its members to permit the FRC and its agents to examine files held by audit firms for the purposes of monitoring quality review processes.
- FRC focus on audit quality: that the FRC propose that its role be revised to target overall audit quality in order to reflect that audit independence is just one element of audit quality.
- Robustness of auditor independence regulation: that the FRC examine further the nature and extent of risks to compliance with current regulatory approaches to audit independence presented by the increasing concentration of firms in audit services, including alternative approaches to regulating auditor independence which mitigate identified risks and provide for market confidence in a robust way into the future.
- Considering elements of the UK model: that the FRC examine further the costs and benefits of particular aspects of the UK model that could improve the performance of the Australian regulatory framework or its contribution to market confidence in auditor independence.

A full list of Allen Consulting's recommendations is contained in Appendix D.

The FRC has already decided to explore further several of the recommendations made by Allen Consulting. While the Allen Consulting report concluded that adoption of the UK financial reporting model is not warranted, it proposed that the FRC examine the costs and benefits of particular aspects of the UK model that could improve the performance of the Australian regulatory framework or its contribution to market confidence in auditor independence and an extension of the FRC's functions to include audit quality (recommendations 6 and 8). The FRC proposes undertaking this work in two stages. During 2007-08, a consultant may be engaged to undertake a mapping of the reporting supply chain, identifying all participants, their role, inter-relationships and the reward-punishment incentives which shape their behaviour. In the second stage, to be undertaken in 2008-09, the FRC would compare the existing Australian and UK models against the conceptual framework to determine whether there is a need to make recommendations to the Minister for refinements to the Australian model.

As part of its 2007-08 work programme, the FRC may also consider whether there is a need for it to make any recommendations to the Minister and the professional accounting bodies about the quality review programmes and disciplinary procedures of the bodies. To facilitate this process, the FRC will shortly publish the Allen Consulting report as a discussion paper on the FRC's website for the purpose of seeking feedback on the recommendations (other than recommendation 8 which, as noted above, will be considered separately) from stakeholders and other interested parties.

3.3 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.

In 2006-07, the FRC continued its work on the teaching of ethics by arranging for a consultant to undertake an evaluation of the way in which business and professional ethics are applied in practice by accounting firms. Further information about the findings and recommendations flowing from this consultancy appear later in this section of the report and in Appendix E.

During this period, the FRC also continued to monitor the adequacy of the teaching of ethics through its periodic meetings with the professional accounting bodies and reviewing publicly available material issued by those bodies. As a result of this work, the FRC did not become aware of any matters that would cause it to be concerned about the adequacy of the teaching of ethics.

Research by the FRC

In April 2006, the Treasury, in consultation with the FRC, engaged Ms Jane Walton of Henderson Walton Consulting Pty Ltd to examine the teaching of professional and business ethics. A summary of the findings and recommendations made by Henderson Walton was published in the FRC's *Report on Auditor Independence 2005-06*.

Henderson Walton's examination of the teaching of professional and business ethics found that the depth of understanding of ethical issues by officers of the three professional accounting bodies and members of accounting firms, their commitment to deal with these issues and steps being taken to do so, are well beyond anything observed in other disciplines, businesses or professions, including law.

In its 2005-06 report, the FRC indicated that it intended to examine the findings and recommendations of the consultant as part of its 2006-07 work programme. However, the FRC subsequently concluded that, before doing this, a more detailed evaluation should be undertaken of how professional and business ethics are applied in practice by accounting firms.

To undertake this project for the FRC, the Treasury engaged Mr Richard Boele of The Banarra Trust. The key requirements of the statement of work for this consultancy are set out in Appendix E of this report.

In its report, Banarra found that ethical practices are highly valued within the profession. Banarra also found that while it could not arrive at any clear conclusions in

terms of ethics practice between the Big Four and the significant other firms, there were clear differences in practice between individual firms. A summary of Banarra's recommendations is set out below.

- Leading ethical practices – proprietary or common goods: the professional bodies, the Accounting Professional and Ethical Standards Board (APESB) and/or the firms themselves could consider establishing a mechanism that facilitates the sharing, reviewing and critiquing of leading ethical practices.
- Extending from lag indicators and outputs to include lead indicators and outcomes: the firms and professional bodies could consider identifying a core set of lead and symptomatic indicators, based upon the leading practice already in place in some firms, that can work as an indication of cultural health and ethics in practice across the profession.
- A more transparent profession: potential clients of the firms should consider requesting lead and symptomatic indicators from those that they are considering appointing.
- FRC going beyond independence: the FRC, in considering what role it has in the business ethics space beyond independence compliance, should also consider the commonly stated 'review and assessment fatigue' amongst firms. Whatever role the FRC seeks to play, it should ensure that the role assumed does not become a barrier to more firms choosing to go beyond compliance and aiming for leading ethical practices.
- Can the FRC show greater leadership: the FRC could show leadership by both facilitating and participating in the debate on the dynamic and evolving tensions between a principles-based and rules-based approach to encouraging ethical behaviour within the profession.

A more detailed outline of the findings and recommendations made by Banarra is contained in Appendix E.

As part of its 2007-08 work programme, the FRC intends considering the need to make recommendations to the Minister and the professional accounting bodies about the promotion and teaching of professional and business ethics by, or on behalf of, the bodies and related matters. To facilitate this process, the FRC will shortly publish the Banarra report as a discussion paper on the FRC's website for the purpose of seeking feedback on the recommendations from stakeholders and other interested parties.

3.4 COMPLIANCE WITH 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.

LEVEL OF COMPLIANCE

In its 2005-06 independence report, the FRC indicated that in 2006-07 it would continue the work of earlier years by reviewing, and analysing, the level of compliance with audit-related disclosure requirements by considering the information provided by the MOU bodies.

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 ASX also provides for that body and the FRC to exchange information.

ASIC has informed the FRC that, as part of its 2006-07 financial reporting surveillance programme, it reviewed 381 financial reports of listed entities with financial years ending between 30 June 2006 and 31 May 2007 (both dates inclusive). As part of that review, ASIC considered the following audit-related disclosure issues:

- Did the directors' report include (including by way of cross-reference to an attached document) an auditor's independence declaration?
- Did the auditor's independence declaration contain any exceptions?
- Did the directors' report include details of non-audit services where there was an indication that such services were provided?
- Did the directors' report include details of non-audit services where it appeared that such services were provided and, where there were details of non-audit services, did the directors' report include an unqualified statement that these services had not affected the auditor's independence?

The results of ASIC's review showed that the majority of financial reports complied with the auditor-related disclosure requirements examined as part of the review. There were, however, a small number of financial reports that failed to comply with these disclosure requirements. One entity failed to include an auditor's independence declaration and there were minor exceptions in the declarations for two other entities. The directors' reports of five companies were identified as failing to disclose non-audit services where it appeared that such services were provided and/or did not include an

unqualified statement that non-audit services had not affected the auditor's independence.

In addition, ASX informed the FRC that it had reviewed financial reports filed by listed entities with ASX under the listing rules during the financial year ending on 31 December 2006. ASX's review included an examination of the form and location of the auditor independence declarations required under section 307C and disclosed by directors under subsections 298(1) and 306(2) of the Corporations Act. The review indicated that, as in previous years, the preferred format for almost all entities was for the declaration to be presented as a separate attachment to the directors' report on the auditor's letter-head with a reference to the attachment in the directors' report.

As part of its 2007-08 work programme, the FRC will continue to review, and analyse, the level of compliance with audit-related disclosure requirements by considering the information provided by the MOU bodies.

PROVISION OF NON-AUDIT SERVICES

The FRC's 2005-06 independence report indicated that the FRC intended doing research and analysis on the quantum of work involved in the provision of non-audit services as part of its 2006-07 work programme.

Preliminary inquiries by the FRC indicated that neither of the key bodies involved in the oversight of Australian corporate activity undertake a comprehensive review of information concerning the provision of non-audit services by the auditors of publicly listed entities. ASX, while examining compliance with a range of audit requirements including the form and location of the auditor independence declarations required under section 307C, does not analyse information about fees for audit and non-audit services except to ensure that the disclosure is made in accordance with the legal requirements. ASIC, the AQRB and the ICAA, which confined their work in this area to an examination of information for those entities whose audit working papers are examined as part of their inspection programmes, did not bring any issues to the FRC's attention.

However, the FRC was able to review information about audit and non-audit fees paid or payable to the auditors of 84 entities, the majority of which are included in the S&P/ASX 100 index. While the FRC has not yet had the opportunity to analyse this information, having regard to the categorisation of the fees for each entity and the structure of the corporate group to which it relates, the FRC's preliminary observations include that:

- fees for audit services represented more than 75 per cent of the total fees of the auditors of 43 entities, while the fees for these services for a further 28 entities were between 50 and 75 per cent of the total fees of their auditors;

- fees for audit and audit-related services represented more than 75 per cent of the total fees of the auditors of 55 entities, while the fees for these services for a further 20 entities were between 50 and 75 per cent of the total fees of their auditors;
- fees for other services represented more than 25 per cent of the total fees of the auditors of 10 entities (including, in the case of two of these entities, more than 50 per cent of their auditors' total fees);
- fees for taxation services represented more than 25 per cent of the total fees of the auditors of 12 entities (including, in the case of two of these entities, one each in the ranges 50 to 75 per cent and over 75 per cent).

As part of its 2006-07 work programme, the FRC also examined IOSCO's March 2007 report on the results of its survey on the regulation of non-audit services provided by auditors to audited companies. Australia was one of 43 countries that participated in this survey, which requested information based on regulations in place as at 31 December 2005. The IOSCO report provides analysis in the following areas:

- specific non-audit services that are permitted, restricted and prohibited for audit clients;
- the auditor independence principles and rationales that are applied in member jurisdictions permitting, restricting or prohibiting non-audit services for audit clients, particularly where there is a prevailing practice;
- the mechanisms or models for regulating and enforcing restrictions on non-audit services by auditors to audit clients;
- where there is no prevailing practice, provides perspective regarding the rationales given for different approaches.

In brief, the IOSCO report contains the following summary and general observations about the review:

- nearly all member jurisdictions regulate the provision of non-audit services in a broad sense, and most also have specific requirements of some type. In general, responsibility for regulation consists of a system that includes a legislative office, securities regulator, auditor oversight board, professional body or some combination of such bodies;
- 88 per cent of respondents regulate non-audit services by setting out principles that, when applied, determine which non-audit services are prohibited;
- over 90 per cent of respondents indicate that legislation and securities regulators have a role with regard to the form or development of auditor independence regulations while all respondents indicate that the rules of local professional bodies are considered in promulgating auditor independence requirements;

- most respondents indicate that the regulation of non-audit services is based on a principles-based approach, with principles most often relating to services that are prohibited rather than those that are permitted;
- 75 per cent of respondents use all or part of the IFAC Ethics Code in some way in establishing independence requirements.

In 2007-08, the FRC proposes to undertake research into the quantum of fees received by auditors of audited entities for audit and non-audit services provided to those entities. The FRC is also of the view that further research on this issue should be undertaken at periodic intervals for the purpose of monitoring trends in the levels of fees received by auditors for audit and non-audit services provided to audited entities.

3.5 OTHER INDEPENDENCE-RELATED ISSUES

This section of the report deals with the following matters:

- issues associated with the CLERP 9 reforms;
- ASIC's inspection powers;
- auditors who are not members of an accounting body;
- staffing issues; and
- non-Corporations Act audits.

ISSUES ASSOCIATED WITH THE CLERP 9 REFORMS

In its previous independence reports, the FRC commented on the anomalies and unintended consequences of CLERP 9 and a number of other issues raised by the MOU parties, accounting firms and other stakeholders with respect to the implementation of CLERP 9. The reports also noted the cooperation between Treasury, ASIC, the accounting bodies and the accounting firms in resolving these issues.

Three issues were addressed through amendments to the *Corporations Regulations 2001* made on 1 June 2006:

- the introduction of an 'ordinary course of business' exemption in relation to the prohibition on an audit firm owing more than \$5,000 to an audit client;
- clarification that cheque and savings accounts are not intended to be covered by the prohibition on loans by an audit firm to an audit client; and
- giving ASIC the power to extend the period within which an auditor is required to resolve a conflict of interest situation beyond the 21 days allowed under the *Corporations Act 2001*.

Two other issues, which related to the auditor's independence declaration, were addressed by ASIC class orders.

Subsequently, in the context of the Government's consultation process to simplify the regulatory system, it was decided that the auditor independence issues dealt with in the *Corporations Regulations* and ASIC class orders should be incorporated into the *Corporations Act*. This was achieved in conjunction with a range of amendments to the *Corporations Act* included in the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*, which was passed by the Australian Parliament during June 2007.

ASIC'S INSPECTION POWERS

In its 2004-05 independence report, the FRC noted that ASIC's powers of inspection in relation to audit firms needed to be clarified. In that report the FRC also noted the release of a consultation paper by the Australian Treasury containing proposals for law reform in this respect.

Following consultation between Treasury and interested parties (including audit firms), changes to ASIC's inspection powers were made during 2006-07, when the ASIC Act was amended to:

- provide ASIC with enhanced information gathering powers in relation to audit inspections; and
- facilitate ASIC entering into cooperative arrangements with foreign regulatory bodies relating to audit regulation.¹²

During July 2007, the Parliamentary Secretary to the Treasurer gave his consent for ASIC to enter into a cooperative audit oversight arrangement with the US Public Company Accounting Oversight Board (PCAOB). The first joint ASIC/PCAOB inspection under this arrangement commenced at one of the major accounting firms during September 2007.

AUDITORS WHO ARE NOT MEMBERS OF AN ACCOUNTING BODY

The 2004-05 independence report included an observation that an issue that needs to be considered further is the case of RCAs who are not members of a professional accounting body and, therefore, are not subject to any of the professional development requirements, ethical requirements, or disciplinary procedures of those bodies.

During 2006-07 the FRC, in consultation with ASIC and the professional accounting bodies, reviewed the Register of Company Auditors to obtain statistical information about the professional affiliations of those auditors. The review was based on the register as at 14 November 2006, when a total of 5,815 individuals were registered.

Key findings of the review were:

- 87.8 per cent of RCAs were members of at least one of Australia's three professional accounting bodies;
- 0.1 per cent of RCAs were members of an overseas-based professional body; and

¹² The amendments were made by the *Australian Securities and Investments Commission Amendment (Audit Inspection) Act 2007* and were effective from 20 February 2007.

- no professional affiliation could be identified for 12.1 per cent of RCAs.

In view of the high number of RCAs for whom no professional affiliation could be identified, ASIC reviewed a 10 per cent sample of those RCAs to obtain information about the size and types of audits being performed by them. The information gathered by ASIC indicates that:

- 67.6 per cent of the RCAs included in the sample had stated in documents lodged with ASIC that they were members of a professional accounting body;
- 14.1 per cent of the sample listed no audits in the latest annual statement lodged with ASIC;
- the sample disclosed that the highest audit fee for both Corporations Act and non-Corporations Act audits was in the band \$20,001-\$50,000: fees of this level were received by 16.7 per cent of those RCAs who performed Corporations Act audits; and
- the maximum audit fee received by the majority of RCAs included in the sample was in the band \$0-\$5,000: maximum fees of this level were received by 61.9 per cent of those auditors who performed Corporations Act audits.

On the basis of these figures, the FRC has formed the view that those RCAs for whom no professional affiliation could be identified do not currently pose a risk for the overall integrity of Australia's auditing regime. Notwithstanding this conclusion, the FRC considers that there should be ongoing monitoring of the number of RCAs who are not affiliated with a professional accounting body.

The FRC believes that, while there is currently no requirement for RCAs to be members of a professional accounting body, there may be merit in the Government giving consideration to making membership of a professional accounting body a prerequisite for registration as a company auditor. Having such a requirement would ensure that all RCAs have on-going obligations to undertake continuing professional development activities so as to ensure that they remain qualified and equipped to discharge their responsibilities as provided for in the legislation. The FRC understands that having membership of a professional body as a prerequisite for registration as a company auditor would bring Australian requirements more closely into line with those in overseas jurisdictions.

STAFFING ISSUES

One of the issues raised with the FRC during its meetings with MOU bodies and other stakeholders was the difficulty of recruiting staff for firms operating within the audit profession. While the recruitment of staff is a matter that is generally outside the FRC's area of responsibility, the FRC does nevertheless maintain a high-level overview of staffing-related developments that may ultimately have consequences for auditors and their independence.

During 2006-07, the FRC's attention was drawn to the fact that audit-related work for some Australian audit clients of a major audit firm was being performed in an offshore jurisdiction using staff engaged by the Australian firm in that jurisdiction. The FRC understands that this development is part of the globalisation that is taking place in many industries and it will monitor such developments for the purpose of considering actual or potential implications for auditor independence. This will include offshore staff of local audit firms being subject to the same standards of disciplinary, quality control and ethical standards that apply to Australian-based staff.

Another issue that was raised with the FRC during the period was the 'fast track' education system introduced by the ICAA in conjunction with Deakin University to bring graduates with non-traditional degrees into the accounting profession. A similar system has been in place in the UK for at least 30 years. The FRC notes that the object of the 'fast track' courses have been introduced to provide, in part, a solution to the long-standing problem of a shortage of accountants in Australia. Many of the audit firms when interviewed remarked that qualified and experienced positions in their audit and assurance business were the most difficult to fill principally because of the growth of the business due to increased regulatory requirements. Western Australia, which has many listed mining companies, was seen to be the most challenging geographic area for the recruitment of staff. The FRC proposes monitoring this positive development as part of its future work programmes, including considering what, if any, implications there may be for auditor independence.

NON-CORPORATIONS ACT AUDITS

While non-Corporations Act audits are not within the prime ambit of the FRC's responsibility, the FRC maintains a watching brief concerning independence issues that may arise in respect of such audits.

During 2006-07, the FRC consulted the Parliamentary Secretary to the Treasurer on whether it would be appropriate for the FRC to expand the scope of its auditor independence work to encompass independence issues in respect of non-Corporations Act audits, especially in the area of self-managed superannuation funds (SMSFs). The Parliamentary Secretary advised the FRC that, as the Government had provided additional funding to the Australian Taxation Office (ATO) of \$112 million over the period 2006-07 to 2009-10 for better regulation of SMSFs (including the effectiveness of SMSF auditors), it would be sensible for the FRC to defer its work for at least

12 months in order to give the ATO sufficient time to make substantial progress in implementing its SMSF auditor programme. The Parliamentary Secretary also indicated that a deferral of the FRC's proposed work on SMSFs would enable the FRC to be better informed by the outcomes from the ATO programme, and that the FRC should raise the issue with the Minister in 2007-08 when the Minister would be in a position to consider the FRC's proposal in light of the progress the ATO had made in implementing its programme for SMSF auditors.

In view of the Parliamentary Secretary's advice, the FRC will limit its work on non-Corporations Act audits in 2007-08 to monitoring any independence issues that may arise in relation to audits of SMSFs and other non-Corporations Act entities.

4. INTERNATIONAL DEVELOPMENTS IN AUDITOR INDEPENDENCE

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 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.

MONITORING DEVELOPMENTS

During 2006-07, the FRC continued its ongoing programme of monitoring international developments through examination of publicly available inspection reports issued by overseas oversight bodies (such as the US Public Company Accounting Oversight Board, the Canadian Public Accountability Board and the Audit Inspection Unit of the UK Professional Oversight Board). In addition, other material placed on the websites of these oversight bodies and associated regulatory agencies was also examined.

One of the more significant international developments during the year was the establishment in September 2006 of IFIAR by the audit regulators of 18 countries, including Australia, Canada and the United Kingdom. In March 2007, the audit regulators of five other countries, including the United States, were admitted as members of IFIAR.

The objectives of IFIAR include:

- sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity;
- promoting collaboration in regulatory activity; and
- providing a focus for contacts with other international organisations which have an interest in audit quality.

Mr Jeffrey Lucy AM, then Chairman of ASIC, was appointed the inaugural Chairman of IFIAR.

The FRC Chairman also met with representatives of overseas oversight bodies during visits to Europe and North America in July 2006 and April 2007.

COMPARATIVE REVIEW OF AUSTRALIAN REQUIREMENTS

In its last report, the FRC reported on a review of Australia's requirements on auditor independence compared with those applicable in other major jurisdictions worldwide. The review, which was undertaken by the Treasury to provide assistance to the FRC, compared the Australian auditor independence requirements with the equivalent requirements applying in Canada, the EU, the UK and the US.

The overall conclusion of the review was that, notwithstanding differences in terminology, institutional arrangements and legal frameworks, there was a substantial underlying equivalence between the Australian auditor independence requirements and 'best practice' standards adopted internationally.

The FRC identified from the review the following areas in which some aspects of the Australian independence requirements differed from the requirements applicable in some or all of the other jurisdictions:

- employment and financial restrictions;
- employment restrictions applying to former audit partners and senior audit personnel ('cooling-off' periods);
- restrictions on multiple former partners of an audit firm; and
- auditor rotation.

After consultation with key stakeholders, the Government amended the following aspects of the auditor independence requirements:

- the multiple former audit firm partner restriction;
 - The restriction applying to multiple former partners of an audit firm will no longer apply to a former partner who has ceased to be a member of the firm for five or more years.
- the former audit partner 'cooling-off' restriction;
 - The way in which the existing two-year 'cooling-off' period applying to a former audit partner of a firm is calculated has been modified. It will be calculated from the date of the last audit in which the person participated rather than the date of departure from the firm.
- the adoption of a 'covered person' approach in relation to the existing financial relationship restrictions.

- The existing specific restrictions on financial investments applying to partners in a firm who are not involved in an audit and not in a position to influence the outcome of an audit were removed. In conjunction with this change, the definition of ‘professional member of an audit team’ was expanded to include any person who recommends or decides what the lead auditor is to be paid in connection with the performance of the audit and any person who provides, or takes part in providing, quality control for the audit.

These changes, which were included with a range of other reforms in the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*, applied from 28 June 2007.

APPENDIX A

FRC'S AUDITOR INDEPENDENCE FUNCTIONS

The FRC's functions include monitoring the effectiveness of auditor independence requirements in Australia and giving the Minister reports and advice about those requirements. These functions are conferred on the FRC under paragraphs 225(1)(c) and (d) and subsection 225(2B) of the ASIC Act.

Under subsection 225(1) of the ASIC Act, the FRC is required to monitor the effectiveness of auditor independence requirements in Australia and to give the Minister reports and advice about those requirements.

In addition, 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 and overall adequacy 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 that 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 disclosures 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.

APPENDIX B

FRC'S PERFORMANCE OF ITS AUDITOR INDEPENDENCE FUNCTIONS

To facilitate the performance of the auditor independence functions, the FRC has:

- established an Audit Independence Committee to deal with day-to-day matters associated with the performance of the function;
- signed MOUs with the professional accounting bodies, ASIC, ASX and APRA (MOU bodies);
- met with the MOU bodies and selected accounting firms;
- appointed a consultant to provide guidance and advice to the FRC in the performance of the function; and
- engaged a number of short-term consultants to perform specific tasks associated with its auditor independence functions.

Audit Independence Committee

The Audit Independence Committee held nine meetings during 2006-07.

Members of the Committee during the year were Ms Elizabeth Alexander AM (Chairman), Mr John Gethin-Jones (from 26 September 2006), Mr David Jackson, Mr Charles Macek and Ms Catherine Walter AM.

The Committee's Charter provides that the Committee will assist the FRC by:

- making recommendations to the FRC concerning the engagement of a person, or persons, to assist the FRC in the performance of the functions conferred on it under subsection 225(2B) of the ASIC Act (the auditor independence consultant);
- performing, either alone or in conjunction with the auditor independence consultant, the work needed to ensure the FRC meets the obligations imposed on it by subsection 225(2B) of the ASIC Act;
- making recommendations to the FRC Chairman concerning the notices that should be given by the Chairman pursuant to section 225A of the ASIC Act; and

- preparing, for the consideration of the FRC, a draft of the report the FRC is required to prepare under section 235BA of the ASIC Act.

Memoranda of Understanding

The FRC has MOUs with the three professional accounting bodies (CPA Australia, the ICAA and the NIA), ASX, APRA and ASIC in order to facilitate the efficient exchange of information between the MOU bodies and the FRC.

In addition, the FRC has a letter of understanding with the CALDB concerning the exchange of information.

Meetings with MOU bodies and audit firms

For the 2006-07 year, meetings were held with the APRA, ASIC, CPA Australia, the ICAA and the NIA. In addition, meetings were also held with the AQRB, the CALDB, the Big Four audit firms and a number of firms in the group immediately below the Big Four.

Appointment of consultants

Mr William Bartlett's contract to undertake the FRC's auditor independence consultancy continued throughout 2006-07.

In addition, during 2006-07 the Treasury, acting on behalf of the FRC, entered into contracts with the following people for the provision of short-term consultancy services:

- The Allen Consulting Group Pty Ltd to review recommendations on quality review programmes and disciplinary procedures of the professional accounting bodies made to the FRC by two short-term consultants engaged during 2005-06 (the statement of work for this consultancy is at Appendix D);
- The Banarra Trust to undertake an evaluation of how professional and business ethics are applied in practice by accounting firms (the statement of work for this consultancy is at Appendix E).

APPENDIX C

AUDIT-RELATED DISCLOSURE REQUIREMENTS OF THE CORPORATIONS ACT AND ACCOUNTING STANDARDS

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

- paragraph 298(1)(c) of the Corporations Act, which requires a company, 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;
- 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 342A¹³, 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 standard of independence for auditors imposed by the Corporations Act;
 - : 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;

13 Section 342A of the Corporations Act outlines the circumstances, and manner, in which ASIC may modify the auditor rotation requirements contained in section 324DA of the 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 for 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).

APPENDIX D

CONSULTANCY TO REVIEW RECOMMENDATIONS ABOUT QUALITY REVIEW PROGRAMMES AND DISCIPLINARY PROCEDURES OF THE PROFESSIONAL ACCOUNTING BODIES

This Appendix contains:

- the statement of work for the consultancy to review recommendations about quality review programmes and disciplinary procedures of the professional accounting bodies; and
- the consultant's recommendations.

As noted elsewhere in this document, the consultant's report will shortly be published on the FRC's website (www.frc.gov.au) as a discussion paper for the purpose of seeking public comments on the recommendations.

Statement of work

1. The purpose of the consultancy is to assess the conclusions and recommendations made by the consultants who reviewed the quality review programmes and disciplinary procedures of the professional accounting bodies ('the short-term consultants') in terms of whether they:

- clearly identify the need for a change to current policies, procedures or regulations by the professional accounting bodies, the Government or other stakeholders in order to better meet stated policy objectives in an efficient and effective manner;
- establish, when Government intervention is recommended, a policy rationale for the proposed intervention which is consistent with the Government's legislative and policy frameworks; and
- include consideration and assessment of alternative means to meet the stated policy objectives.

2. The Consultant will:

- where Government intervention is proposed, consider if the recommendations of the short-term consultants represent sound and realistic proposals for reforming existing Government policies, having regard to:
 - where legislative amendments are needed to implement any recommendations, whether the Commonwealth Government has the necessary constitutional powers (including the corporations powers referred to the Commonwealth by the States and Northern Territory) to enact that legislation;
 - whether any recommendations would, or would have the potential to, conflict with the requirements of other Commonwealth legislation, including legislation dealing with privacy, trade practices and work-place relations; and
 - whether the underlying objectives of some, or all, of the recommendations could be achieved by alternative means such as reforms to existing legislative provisions or institutional arrangements; and
- prepare a report for the Financial Reporting Council (FRC) detailing their findings and including recommendations for further actions that could be considered by the FRC.

3. Without limiting the scope of the work to be done, it is expected that in examining the recommendations the consultant will:

- consider feedback on the short-term consultants' findings and recommendations received by the FRC from its stakeholder bodies;
- consult, as appropriate, the stakeholder bodies to clarify any issues associated with their feedback on the short-term consultants' findings and recommendations;
- seek the views of:
 - representatives of those who 'consume' audited financial reports (including shareholders and company directors); and
 - those who have some direct experience of the quality review programmes and disciplinary procedures of the professional accounting bodies; and
- consider the experience of the United Kingdom Financial Reporting Council in implementing arrangements equivalent to those recommended by the consultants.

Consultant's recommendations

The recommendations made by the consultant in its report to the FRC are listed below.

1: Analysing market confidence in auditor independence

That the FRC sponsor a stakeholder mapping of different segments of users of audited financial information; and a survey of their confidence that company-issued audited financial reports reflect actual business performance, the basis for this confidence, the confidence in the auditor's independence from the company's interests specifically, their view of any gap in confidence relative to the optimal level, and the level of understanding of the existing regulatory framework for auditor independence.

The data produced would then provide the basis for thorough assessment of proposed changes to the existing regulatory framework within the standard framework of regulatory analysis.

The survey work should not commence until 2007-08 – at least one year from the introduction of the Audit Standards into the Corporations Act.

2: Market understanding of the regulatory framework

That the FRC advise the Minister that:

- an information programme to improve the understanding of the current regulatory framework, explain the specific roles of the various parties and the inter-relationships between these parties, and focus on improving the understanding within the profession of the roles of ASIC and the CALDB and their statutory requirements in fulfilling those roles and the rationale for the CALDB's establishment under the same statute in particular, be undertaken; and
- the CALDB's recent information sessions on its role may provide an example to be applied more broadly.

3: Coverage of RCAs

That the FRC recommend that Government collect information on the number and nature of the audits undertaken by the 13 per cent of RCAs who are active and do not have membership with any of the professional accounting bodies, and the professional development training they undertake, and consider whether there is a case for regulatory change in light of the risk to market confidence in auditor independence supported by this data.

4: Efficiencies in quality review effort

That the FRC recommend that, following completion of the AQRB's initial reviews, key stakeholders review the resources, scope and outcomes of all quality reviews undertaken to identify any opportunities to reduce the review burden on audit firms while maintaining an acceptable level of market confidence in auditor independence.

5: Enabling FRC's quality review monitoring

That the FRC formally request that each professional accounting body seek consent, including amendment to existing undertakings if required, from each of its members to permit the FRC and its agents to examine files held by audit firms for the purposes of monitoring quality review processes.

6: FRC focus on audit quality

That the FRC propose that its role be revised to target overall audit quality in order to reflect that audit independence is just one element of audit quality, both conceptually and in practice as reflected in the activities of both regulators and professional accounting bodies.

7: Robustness of auditor independence regulation

That the FRC examine further the nature and extent of risks to compliance with current regulatory approaches to audit independence presented by the increasing concentration of firms in audit services, including alternative approaches to regulating auditor independence which mitigate identified risks and provide for market confidence in a robust way into the future.

8: Considering elements of the UK model

While adoption of the UK model is not warranted, that the FRC examine further the costs and benefits of particular aspects of the UK model that could improve the performance of the Australian regulatory framework or its contribution to market confidence in auditor independence. In particular, that the FRC consider the scope to enhance transparency and provide greater information on disciplinary decisions made by regulatory decision makers by:

- adoption of public hearings for CALDB hearings as for the UK Accountancy Investigation and Disciplinary Board; and
- support for the proposed requirement that the CALDB publish the full reasons for its determinations on its website.¹⁴

¹⁴ Following the preparation of this recommendation by Allen Consulting, the Government amended section 1296 of the Corporations Act to provide that if the CALDB decides to exercise any of its powers under section 1292 to cancel or suspend the registration of a person as an auditor, the Board may take such steps as it considers reasonable and appropriate to publicise the decision and the reasons for the decision (including making the decision and reasons available on the internet).

APPENDIX E

CONSULTANCY TO EVALUATE HOW PROFESSIONAL AND BUSINESS ETHICS ARE APPLIED IN PRACTICE BY ACCOUNTING FIRMS

This Appendix details:

- the statement of work for the consultancy to evaluate how professional and business ethics are applied in practice by accounting firms; and
- the consultant's findings and recommendations.

The consultant's report will shortly be published on the FRC's website (www.frc.gov.au) as a discussion paper for the purpose of seeking public comments on the findings and recommendations.

Statement of work

1. The purpose of the consultancy is to evaluate how professional and business ethics are applied in practice by accounting firms. It is envisaged that the consultancy will consider the Big Four accounting firms and three firms agreed by the Consultant and the Audit Independence Committee of the Financial Reporting Council (FRC) in the group immediately below the Big Four firms.
2. Without limiting the scope of the work to be done, it is expected that the Consultant will consider:
 - the extent to which the accounting firms ensure their partners and staff are aware of, and comply with, the ethical requirements of the professional accounting bodies;
 - whether the accounting firms have their own ethical requirements which supplement those of the professional bodies and, where they do, the extent to which partners and staff comply with them;
 - whether accounting firms take disciplinary or other action against partners or staff who fail to comply with the ethical requirements of either their professional body or the firm;
 - whether firms reward partners and staff for maintaining high ethical standards, even in circumstances where there is a resultant financial loss to the firm; and

- any observations, findings or recommendations made by the Consultant who reviewed the teaching of professional and business ethics by, or on behalf of, the professional accounting bodies about the manner in which professional and business ethics are applied in practice by accounting firms.
3. The Consultant will prepare a report for the FRC detailing its findings and including recommendations for further actions that could be considered by the FRC.
4. The performance of the work specified in paragraphs 2 and 3 will be undertaken in three stages:
- research concerning the environment, processes and procedures impacting on ethical performance in accounting firms;
 - testing the extent to which the accounting firms being considered can identify, understand and respond to the issues associated with their ethical performance; and
 - preparation of a report by the Consultant on its findings and recommendations.

Consultant's findings and recommendations

The findings and recommendations made by the consultant in its report to the FRC are outlined below.

The consultant arrived at the following general findings:

- Ethical practices are highly valued, especially in the context of the firms' demonstrated understanding that unethical practices damage their reputations and brands.
- Organisational values are articulated by all the firms. As a result of this values-based building of culture and the other evidence collected we are able to conclude that the firms are focused on actioning preferred behaviours and these include ethical behaviours.
- Size does not matter as there were no clear significant differences between the Big Four and the significant other firms reviewed, but there are differences between individual firms.
- The profession has leading ethical practices.
- Significant resources are being invested by the firms to ensure compliance with independence and quality requirements, however ethics in practice is more than independence.

- Some firms' risk management functions are not working as closely with HR as they could to leverage fully the HR data contained in employee-surveying mechanisms to understand the firm's ethical cultural health.
- The tension between a principles-based versus rules-based approach to encouraging ethical behaviour continues.
- The FRC's ethical supervisory responsibilities are seen by the firms as limited to independence and our broader scope created concern from some review participants, who saw this as the FRC overreaching its responsibilities in relation to ethics. All of the firms cooperated and most welcomed the opportunity presented by the review.

Key issue specific findings included:

- Most firms have mechanisms such as employee surveys which are monitoring cultural health through specific questions.
- Firms are declining work with decisions where ethics is a factor.
- Approaches to whistleblower mechanisms are different. Small numbers of cases have been recorded. Those firms asserted that the numbers are low because ethical practice is very strong within the firm. This uses the number of cases as a lag indicator of strong ethical practice; a valid function for the indicator once widespread confidence in the mechanism can be demonstrated.
- Leading firms have embedded into their performance management processes explicit expectations in relation to ethical behaviour, such as acting with integrity and in some cases this is being tied to remuneration. There are clear sanctions in all firms for those who behave unethically and there is evidence that these sanctions are applied.
- The monitoring of ethical training is primarily focused on 'outputs', for example the number of people who complete the training rather than 'outcomes' as in the effectiveness of the training.
- There is significant difference between firms in terms of how they use symptomatic or 'lead' indicators, such as the results of employee surveys and diversity performance, as indicators of cultural health, with some firms well developed in this area.

Recommendations from the review are:

1: Leading ethical practices — proprietary or common goods

- The professional bodies, the Accounting Professional and Ethical Standards Board (APESB) and/or the firms themselves could consider establishing a mechanism that facilitates the sharing, reviewing and critiquing of leading ethical practices.

2: Extending from lag indicators and outputs to include lead indicators and outcomes

- The firms and professional bodies could consider identifying a core set of lead and symptomatic indicators, based upon the leading practice already in place in some firms, that can work as a comparable proxy for cultural health and ethics in practice across the profession.
- The FRC could consider the greater use of lead and symptomatic indicators of cultural health and ethics in practice in delivering its supervisory responsibilities.
- The firms could review their approach to evaluating ethics training with a view to extending from measuring outputs (that is, the number of employees who have completed them) to include outcomes also.

3: A more transparent profession

- Potential clients of the firms should consider requesting lead and symptomatic indicators from those that they are considering appointing.
- Beyond users of the firms' services, other stakeholders of the profession could also begin to request this additional information relating to ethical performance and ask specifically that it be put in the public domain so that those stakeholders can come to their own conclusions in relation to ethical performance.
- Company directors, when considering audit reports, could request of the auditor an explanation of how ethical practice has been assured in the conduct of the engagement.

4: FRC going beyond independence

- In considering what role the FRC has in the business ethics space beyond independence compliance, it should also consider the commonly stated 'review and assessment fatigue' amongst firms. Whatever role the FRC seeks to play, it should ensure that the role assumed does not become a barrier to more firms choosing to go beyond compliance and aiming for leading ethical practices.

5: Can the FRC show greater leadership?

- FRC could show leadership by both facilitating and participating in the debate on the dynamic and evolving tensions between a principles-based and rules-based approach to encouraging ethical behaviour within the profession.

APPENDIX F

MATTERS ARISING FROM 2005-06 INDEPENDENCE REPORT

The following tabulation lists the matters arising from the 2005-06 independence report and the action that has been taken in respect of each matter.

Page	Issue	Action
2, 6, 19, 45	The FRC intends to examine the findings and recommendations made by the disciplinary procedures consultancy as part of the FRC's 2006-07 work programme.	The Allen Consulting Group was engaged to review the recommendations made by the disciplinary procedures consultant. Allen Consulting's recommendations, which are listed in Appendix D, will be considered by the FRC in consultation with stakeholders during 2007-08.
2, 6, 18, 41	The FRC intends to examine the findings and recommendations made by the quality review programmes consultancy as part of the FRC's 2006-07 work programme.	The Allen Consulting Group was engaged to review the recommendations made by the quality review consultant. Allen Consulting's recommendations, which are listed in Appendix D, will be considered by the FRC in consultation with stakeholders during 2007-08.
2, 3, 6, 20, 49	The FRC intends to examine the findings and recommendations made by the consultancy on the teaching of professional and business ethics as part of the FRC's 2006-07 work programme.	The FRC decided that, prior to considering the recommendations made by the ethics consultant, an evaluation should be undertaken of how professional and business ethics are applied in practice by accounting firms. The Banarra Trust was engaged to carry out this work. Banarra's recommendations, which are listed in Appendix E, and the recommendations of the ethics consultant will be considered by the FRC in consultation with stakeholders during 2007-08.
3, 6, 23	In 2006-07, the FRC plans to review the level of compliance with audit-related disclosure requirements by considering the information provided by MOU bodies.	Information has been provided by ASIC and ASX to assist in this task.
3, 6, 28, 29, 30	The FRC will consider issues identified during the comparative review of Australian and overseas independence requirements as part of the FRC's work programme for 2006-07.	The FRC provided advice to the Parliamentary Secretary to the Treasurer on the matters identified in the comparative review during December 2006.
3, 6, 25	The FRC intends to give further consideration, as part of its 2006-07 work programme, as to whether any scope exists for reducing the overlap of auditor review responsibilities between the firms, professional accounting bodies and regulators.	The FRC has addressed this issue through meetings with stakeholder bodies.

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Page	Issue	Action
14	The FRC intends to do further research and analysis on the provision of non-audit services by auditors as part of its 2006-07 work programme.	The FRC initially experienced difficulty in obtaining information on this subject. However, a schedule of audit fees paid by most of the top 100 companies has been obtained and an analysis of the data will be undertaken during 2007-08.
26	The report notes that the FRC is reviewing the register of company auditors to identify the number of registered company auditors who are not members of a professional accounting body and that this project will be completed during the first half of 2007.	This project was completed on schedule during the first half of 2007.

APPENDIX G

AUDITOR INDEPENDENCE FUNCTIONS: 2007-08 WORK PROGRAMME

Function	Approved work programme for 2007-08
<p>Monitoring and assessing the nature and overall adequacy of the systems and processes used by Australian auditors to ensure compliance with auditor independence requirements.</p>	<p>Information concerning the performance of this function should continue to be provided by ASIC (under the terms of the MOU with the FRC).</p> <p>In addition, the FRC will monitor the AQRB's work in this area and consult, as necessary, accounting firms that conduct audits of listed entities.</p>
<p>Monitoring and assessing the nature and overall adequacy of:</p> <ul style="list-style-type: none"> (a) 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 that those reviews relate to auditor independence requirements; (b) 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; and (c) 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. 	<p>The FRC's work in respect of this function will flow from the reports of the consultants and the recommendations contained in those reports.</p> <p>The FRC will be consulting with the professional accounting bodies and other stakeholders concerning the recommendations of the consultants.</p>
<p>Monitoring and assessing the nature and overall adequacy of the investigation and disciplinary procedures of professional accounting bodies as those procedures apply to Australian auditors.</p>	<p>The FRC's work in respect of this function will flow from the reports of the consultants and the recommendations contained in those reports.</p> <p>The FRC will be consulting with the professional accounting bodies and other stakeholders concerning the recommendations of the consultants.</p>
<p>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. (These disclosure requirements are listed in Appendix C.)</p>	<p>As part of its 2007-08 work programme, the FRC will review, and analyse, the level of compliance with audit-related disclosure requirements by considering the information provided by the MOU bodies.</p>
<p>Giving the Minister reports and advice about the matters referred to above.</p>	<p>Monitor developments on an ongoing basis and provide reports and advice on an 'as required' basis.</p>

Function	Approved work programme for 2007-08
<p>Giving professional accounting bodies reports and advice about matters related to their quality assurance reviews and disciplinary procedures as detailed above.</p>	<p>Monitor developments on an ongoing basis and provide reports and advice on an 'as required' basis.</p>
<p>Monitoring international developments in auditor independence, assessing the adequacy of the Australian auditor independence requirements provided for in:</p> <ul style="list-style-type: none"> (a) the Corporations Act; and (b) codes of professional conduct; <p>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</p>	<p>In 2007-08, the FRC should continue to perform this function by:</p> <ul style="list-style-type: none"> (a) monitoring media reports and information on relevant websites (this information is provided to all FRC members on a monthly basis); and (b) meeting with appropriate bodies in other jurisdictions as part of overseas visits by the FRC chairman.
<p>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.</p>	<p>The FRC's work in respect of this function will flow from the reports of the consultants and the recommendations contained in those reports.</p> <p>Consultation/negotiations with the professional accounting bodies and the APESB may be needed concerning the implementation of recommendations accepted by the FRC and agreed with these bodies.</p>
<p>Other matters.</p> <ul style="list-style-type: none"> (a) Non-Corporations Act audits (in particular, self-managed superannuation funds). (b) Number of registered company auditors (RCAs) who are not members of a professional accounting body. (c) Issues associated with the provision of non-audit services. (d) Planning of work on analysing market confidence in auditor independence. 	<p>The 2007-08 work programme does not envisage any direct action in respect of this matter.</p> <p>However, given the terms of the then PST's letter of 15 May 2007, the FRC should monitor/consider any independence issues that arise in respect of non-Corporations Act audits so that it is able to provide appropriate advice to the Minister at the expiration of the 12-month period. The advice to the Minister could result in work in this area being programmed in 2008-09.</p> <p>The FRC Secretariat has completed its analysis of the Register of Auditors. As a result of that analysis, supplementary information will be sought from ASIC and the professional accounting bodies.</p> <p>The FRC Secretariat could undertake research on this issue during 2007-08. A schedule of audit fees paid by most of the top 100 companies has been obtained and an analysis of the data will be undertaken.</p> <p>The FRC plans to undertake a stakeholder mapping of different segments of users of audited financial information; and a survey of their confidence that company-issued audited financial reports reflect actual business performance, the basis for this confidence, the confidence in the auditor's independence from the company's interests specifically, their view of any gap in confidence relative to the optimal level, and the level of understanding of the existing regulatory framework for auditor independence.</p>