

# **Financial Reporting Council**

Annual Report 2009-10

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## Australian Government

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11 October 2010

The Hon Wayne Swan MP  
Deputy Prime Minister and Treasurer  
Parliament House  
CANBERRA ACT 2600

Dear Deputy Prime Minister

I have pleasure in presenting the annual report of the Financial Reporting Council (FRC) for the year ended 30 June 2010.

The report has been prepared in accordance with sections 235B and 235BA of the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

Subsection 235B(1) of the ASIC Act requires the FRC to prepare a report on its operations during the year, and on the achievement of the objects of Part 12 of the ASIC Act relating to accounting and auditing standards. Subsection 235BA(1) of the Act requires the FRC to prepare a report on its performance of its auditor independence functions, the findings and conclusions reached by the FRC in performing those functions, and the actions (if any) taken by the FRC in respect of those findings and conclusions.

Subsections 235B(4) and 235BA(3) of the ASIC Act require the report to be tabled in each House of the Parliament as soon as practicable.

Yours sincerely

SIGNED  
Jeffrey Lucy AM  
Chairman



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## INTRODUCTION

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The Financial Reporting Council (FRC) is the peak body responsible for the broad oversight of the accounting and auditing standards setting processes for the public and private sectors in Australia, for monitoring the effectiveness of Australia's auditor independence requirements, and for advising the responsible Minister on these matters.

The Council's members are appointed by the Minister on the basis of nominations made by key stakeholders in the business and investing communities, the professional accounting bodies, governments and regulatory agencies. As at 30 June 2010, the Council had 19 members, all of whom had been appointed on a part-time basis.

As part of its role of overseeing the standards setting processes, the FRC's responsibilities include appointing the members (other than the Chairs) of the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB), determining the broad strategic directions of the AASB and AUASB. The FRC's responsibilities also include giving advice or feedback to the AASB and AUASB on their priorities, business plans and procedures and to the Offices of the AASB and AUASB on their budgets and staffing arrangements.

The AASB deals with the setting of accounting standards for the public and private sectors of the Australian economy, while the AUASB focuses on the development and setting of auditing and assurance standards and guidance. Both Boards are agencies for the purposes of the *Financial Management and Accountability Act 1997* and are preparing separate annual reports for the Minister concerning their operations during 2009-10.

Under the auditor independence function, the FRC is responsible for monitoring the systems and processes used by Australian auditors to ensure their compliance with auditor independence requirements. The FRC also monitors the professional accounting bodies' planning and performance of quality assurance reviews of audit work undertaken by Australian auditors to the extent to which those reviews relate to auditor independence requirements.

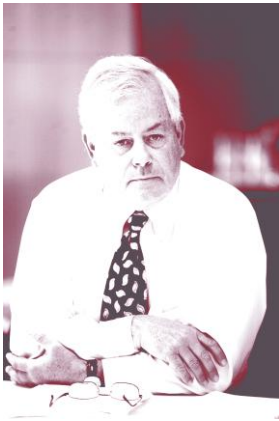
In the performance of these functions, the FRC is assisted by a Secretariat which is located at the Treasury.

The FRC meets at least once each quarter to perform its functions associated with the oversight of the standards setting processes and monitoring the effectiveness of the auditor independence requirements. Funding for the FRC is provided through an Australian Government appropriation.



## CHAIRMAN'S REPORT

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The first of January 2010 was an important milestone in the history of the FRC – the tenth anniversary of the Council's establishment.

Much has been achieved over that period of time. And there is still much more to do.

Originally established to provide broad oversight of the processes for setting Australian accounting standards, the Council's role was expanded in 2004 to include oversight of the processes for setting Australian auditing and assurance standards and responsibility for monitoring the effectiveness of Australia's auditor independence requirements.

The FRC's key achievements during its first decade have included:

- providing, in 2002, a strategic direction to require the AASB to work towards the adoption in Australia of accounting standards that are the same as those issued by the International Accounting Standards Board (IASB) for accounting periods beginning on or after 1 January 2005;
- issuing, in December 2002, a strategic direction to require the AASB to pursue as an urgent priority the harmonisation of government finance statistics (GFS) and generally accepted accounting principles (GAAP) reporting;
- providing, in April 2005, a strategic direction to require the AUASB to develop Australian auditing standards that have a clear public interest focus and are of the highest quality, and to use, as appropriate, International Standards on Auditing of the International Auditing and Assurance Standards Board (IAASB) as a base from which to develop the Australian standards;
- the endorsement, during May 2009, of Australia's adoption of the IAASB's clarity standards in accordance with the timeline proposed by the AUASB;
- working with other jurisdictions in the Asia-Oceania region to promote the adoption of, or convergence with, International Financial Reporting Standards (IFRS) in the region and to support the IASB's effort to establish a single set of high-quality global accounting standards; and

- the successful cooperative arrangements that have been established with New Zealand.

As the FRC moves into its second decade, it will maintain its international focus on promoting the world-wide adoption of IFRS. Domestically, the changes made during 2008 to the governance arrangements of the AASB and AUASB mean that the FRC has greater capacity to examine policy-related issues associated with Australia's financial reporting framework. As noted elsewhere in this report, a strategic planning session held in May 2010 has identified a range of matters for consideration by the FRC during 2010-11.

## **Achievements in 2009-10**

The year under review was a busy one for the FRC and its Secretariat. While the FRC's achievements are outlined in greater detail later in this report, a few matters I would like to briefly mention are:

- participation in the fourth IFRS Regional Policy Forum in Singapore in May 2010;
- hosting a high-level business delegation from Japan that visited Australia to investigate the adoption of IFRS in this country;
- meetings with a range of bodies from the accounting and auditing communities in Europe and North America;
- reviewing developments concerning completion of the AASB's project to harmonise GAAP and GFS reporting;
- holding a workshop to consider Australia's differential reporting framework; and
- holding a strategic planning session in May 2010 to look to the future of the FRC and to determine what it might seek to deliver in the next 12 months.

## **Oversight of the accounting and auditing standards setters**

With the revised governance arrangements for the AASB and AUASB now bedded down, there has been a reduction in the day-to-day interaction between the FRC, its Secretariat and the Boards.

During 2009-10, the FRC monitored the activities of the Boards for the purpose of performing its statutory functions of determining the broad strategic directions of the Boards and providing advice or feedback to the Boards about their priorities, business plans and procedures and to their respective Offices about their budgets and staffing arrangements. This work is facilitated by the comprehensive reports provided to each FRC meeting by the Chairs of the Boards and discussion about the reports at those

meetings. As a result of this interaction, there was no need for changes to the broad strategic directions to the Boards or the provision of formal advice or feedback to either Board.

In September 2009, the FRC approved the re-appointment of three members to the AASB and two to the AUASB, all for three-year terms commencing on 1 January 2010.

For a number of years, the FRC has had an opportunity to meet formally with one or both of the standards-setters. During 2009-10, I had the opportunity to meet with the AASB but the FRC as a group did not have that opportunity. In the coming year, I propose consulting the Chairs of the Boards about the resumption of such meetings, as they provide an excellent opportunity for members of the FRC and the Boards to exchange views on matters of mutual interest.

## **Auditor independence**

During the year, the FRC continued its function of monitoring the effectiveness of the auditor independence requirements in Australia. The FRC performs this work primarily through obtaining information from the Australian Securities and Investments Commission (ASIC) and the other bodies with which it has a Memorandum of Understanding (MOU) and through periodic meetings with those bodies and other stakeholders, such as auditing firms.

The overall conclusion reached by the FRC as a result of its 2009-10 work on auditor independence is that the independence framework continues to operate effectively.

In the FRC's 2008-09 annual report, I proposed that Treasury review the FRC's auditor independence functions for the purpose of considering whether this role should be maintained into the future. I was pleased to see that Treasury sought comments on this proposal in the 'Audit Quality in Australia: A Strategic Review' paper released in March 2010. I am advised that Treasury is currently considering the public comments on this and other proposals contained in the paper for the purpose of providing briefing to the Parliamentary Secretary to the Treasurer for his consideration.

## **Outlook for 2010-11**

The coming year is expected to see significant financial reporting-related developments at both the international and domestic levels. These developments are likely to create a range of issues for consideration by the FRC, Australia's accounting and auditing standards-setters and stakeholders in the financial reporting process.

Internationally, global financial crisis-related projects being undertaken by the IASB and the US Financial Accounting Standards Board (FASB) at the urging of G-20 Leaders are scheduled to be completed during the first half of 2011. Significant progress can also be expected during 2010-11 on the convergence of IASB and FASB

accounting standards. The new and amended IFRS developed as part of these projects may result in some short-term implementation issues for Australian preparers and auditors of financial statements, but the longer-term benefits of the higher quality accounting standards will out-weigh any transitional issues.

The use of IFRS will expand during 2010-11 with a number of additional jurisdictions, including Argentina, Brazil and Canada, requiring their use for the preparation of financial statements for listed entities. In Asia-Oceania, the Republic of Korea will require the use of IFRS from 2011 while India will commence a process of converging with IFRS over a period commencing on 1 April 2011. It is also envisaged that the US will make a decision during 2011 on the future role of IFRS in domestic financial reporting by US companies.

Domestically, the FRC will devote resources to consideration of the issues identified at the strategic planning session held in May 2010. The FRC will be progressing this work in consultation with its stakeholder bodies including, where appropriate, inviting them to participate in the work being undertaken.

As in past years, the FRC will also monitor, in consultation with the standards-setting bodies and other stakeholders, the operation of Australia's accounting and auditing standards, having particular regard to recent changes such as the commencement of the 'clarity' auditing standards and the differential reporting requirements.

## **Acknowledgements**

I thank all of my colleagues for the hard work and time they have put into the FRC and its Committees during 2009-10.

I welcome the appointments of Mr Kevin Stevenson and Dr Stein Helgeby to the FRC and thank retiring members Ms Kathryn Campbell and Mr John Trowbridge for their expertise and commitment to the Council during their tenure.

On behalf of the Council, I also want to thank the Secretariat for enabling the work of the Council and its Committees to be carried out in a timely and effective manner and to thank the outgoing FRC Secretary, Ms Genevieve Watson, for her contribution and efforts over the last 12 months. Finally, I welcome Mr Michael Lim as the new FRC Secretary from August 2010.

The coming year promises again to be challenging. I look forward to working with all stakeholders in ensuring that the FRC continues to show leadership on emerging issues both here in Australia and internationally.

SIGNED

Jeffrey Lucy AM

Chairman of the Financial Reporting Council

11 October 2010



## **FRC HIGHLIGHTS FOR 2009-10**

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### **International activities**

- The FRC participated in the fourth IFRS Regional Policy Forum in Singapore on 13 May 2010. The Forum provided an opportunity for participants from the Asia-Pacific region to discuss issues facing the IASB in the quest for global convergence and IFRS adoption. Meeting participants reaffirmed their commitment to accelerate the convergence and adoption of IFRS as a set of high-quality global accounting standards in the Asia-Oceania region.
- A high-level business delegation from Japan visited Australia during September 2009 to investigate the adoption of IFRS in Australia. The delegation met with a large number of Australian stakeholders. The meetings were particularly valuable in highlighting to the Japanese delegation the value of moving to IFRS.
- During September and October 2009, the FRC Chairman and Secretary held meetings with a range of bodies from the accounting and auditing communities in Europe and North America.
- In keeping with moves towards closer economic relations between Australia and New Zealand, the FRC Chairman was a member of both the Trans-Tasman Accounting and Auditing Standards Advisory Group (TTAASAG) and the New Zealand Accounting Standards Review Board (ASRB) throughout the period covered by this report. In addition, the Chairman of the ASRB was also a member of the FRC throughout the period.

### **Domestic activities**

- The FRC's engagement with domestic stakeholders and other interest groups was addressed in a number of ways, including through liaison between stakeholders and their respective nominees on the Council, and presentations at FRC meetings on issues of relevance to the Council and its stakeholders. During the period, the FRC Chairman met with a range of organisations, including accounting firms, the professional accounting bodies, industry groups and regulatory bodies.

- In December 2009, the FRC reviewed developments concerning the completion of the AASB's project to harmonise GAAP and GFS reporting. In particular, the FRC focused on whether the AASB's tentative decision to develop proposals to amend Australian accounting standards to facilitate GAAP/GFS harmonisation for entities within the general government sector into non-mandatory guidance (rather than an accounting standard) would satisfy the strategic direction given to the AASB in December 2002. The FRC concluded that the AASB's tentative decision would not satisfy the strategic direction and the AASB Chairman was therefore asked to inform the AASB of the FRC's views and to work to meet the objectives of the direction.
- The FRC held a workshop in August 2009 to consider a range of issues including the appropriateness of Australia's differential reporting framework and the role (if any) that the IASB's IFRS for small and medium-sized entities (SMEs) should have in that framework. The workshop agreed that a discussion paper should be prepared for consultation with stakeholders and other interested parties. At the conclusion of a consultative process undertaken by the AASB, the Board decided that a two tiered disclosure regime should be adopted with lower disclosure requirements for entities that are not public interest entities.
- The FRC held a strategic planning session as part of its May 2010 meeting. The purpose of the session was to: look to the future of the FRC; and determine what the Council might seek to deliver in the next 12 months. Matters identified for further consideration included: a review of Australia's regulatory financial reporting environment; the increasing complexity of corporate reporting; financial reporting issues arising out of the global financial crisis; and risk reporting.
- In March 2010, the FRC Chairman released a Treasury consultation paper 'Audit Quality in Australia: A Strategic Review'. The paper identifies the drivers of audit quality in Australia and assesses whether any measures should be taken to address any real or perceived threats to these drivers of audit quality. The Treasury is currently considering the public comments on this and other proposals contained in the paper for the purpose of providing briefing to the Minister for his consideration.
- Mr Tim Flynn, Chairman of KPMG International and KPMG LLP, its member firm in the United States of America (US), delivered the 2010 Ken Spencer Memorial Lecture in Melbourne on 2 March 2010. His lecture was titled '*Restoring Trust and Building Confidence*' and dealt with a broad set of issues arising out of the global financial crisis.

## **Oversight of Australian standards setting**

- In September 2009, the FRC approved the re-appointment of three existing members to the AASB and two existing members to the AUASB.
- During the period covered by this report, the FRC complied with its statutory obligations to give advice or feedback to the Boards and their Offices and to determine the broad strategic directions of the Boards, using reports provided to each FRC meeting by the Chairmen of the Boards about the activities of their respective Boards and through out-of-session meetings with the Chairmen of the Boards and other stakeholders.

## **Monitoring auditor independence**

- During 2009-10, the FRC monitored the nature and overall adequacy of the systems and processes used by audit firms to ensure compliance with auditor independence requirements by gathering information from ASIC, by reviewing reports published by The Institute of Chartered Accountants in Australia (ICAA) and by obtaining and analysing information from the professional accounting bodies. Based on this work, the FRC formed the view that the systems and processes used by audit firms were acceptable, although it noted that there is scope for improvements to the systems and processes of some firms.
- On the basis of information provided by the professional accounting bodies, the FRC did not become aware of any deficiencies in either the systems or processes used by the bodies for planning and performing quality reviews of audit work, or in the overall adequacy of the professional accounting bodies' investigation and disciplinary procedures.

## **Governance and administration**

- As at 30 June 2010, the FRC had 19 members. During the year two members retired while two new members were appointed.
- Four regular meetings of the FRC were held during the year. In addition, the FRC held one workshop on differential financial reporting.

## ENQUIRIES

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Initial queries relating to the Financial Reporting Council's annual report may be directed to the Secretary, Financial Reporting Council:

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Website: <http://www.frc.gov.au>

# 1 INTERNATIONAL ACTIVITIES

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## 1.1 INTRODUCTION

The last 12 months have seen the FRC involved in, or monitoring, a range of activities associated with, or having the potential to impact on, international accounting and auditing standards setting. The FRC's interest in this area is two-fold:

- its statutory obligations include monitoring the development of international accounting and auditing standards and furthering the development of single sets of accounting and auditing standards for world-wide use; and
- having regard to Australia's decision to adopt international accounting standards for financial years commencing on or after 1 January 2005, seeking to ensure that the standards that are being developed by the international standards setters are, and continue to be, in Australia's best interests.

During this period, the FRC primarily focused on:

- decisions by G-20 Leaders and the convergence of IASB and FASB accounting standards, that impact on the existing body of IFRSs and the development of new and amended standards;
- fostering institutional arrangements in the Asia-Oceania region to promote the adoption of IFRSs by countries in the region and to give the region a stronger voice in the process for setting international accounting standards; and
- an expansion of the cooperative arrangements with New Zealand.

## 1.2 DEVELOPMENTS IMPACTING ON IFRSs

As noted above, the key international developments impacting on IFRSs during 2009-10 were the continuing deliberations of G-20 Leaders about measures to address the consequences of the global financial crisis, work within the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision to improve the interaction between accounting standards and the financial sector, and ongoing work on global convergence of accounting standards.

Two G-20 Leaders' meetings were held during the period: in Pittsburgh USA on 24-25 September 2009 and in the Canadian city of Toronto on 26-27 June 2010. The Pittsburgh meeting focused on the adoption of a set of policies, regulations and

reforms to meet the needs of the 21st century global economy, while the Toronto meeting considered further steps to reform and strengthen the global financial system.

The two meetings resulted in similar calls being made regarding accounting standards:

- urging the IASB and the FASB to increase their efforts to complete their convergence project by 2011; and
- encouraging the IASB to improve the involvement of stakeholders, including emerging market economies.

Prior to the Toronto meeting, the IASB and FASB notified the G-20 and FSB that their full convergence project would not be completed by the original June 2011 deadline, although the most important elements would be.

## **1.3 ASIA PACIFIC ACCOUNTING DEVELOPMENTS**

### **IFRS Regional Policy Forum**

The fourth IFRS Regional Policy Forum was held in Singapore on 13 May 2010. The Forum, which was hosted by the Singapore Accounting Standards Council with the support of the Singapore Ministry of Finance and the Accounting and Corporate Regulatory Authority, was attended by more than 100 participants from Australia, Brunei, China, India, Indonesia, Japan, South Korea, Macau SAR, Malaysia, New Zealand, Singapore, Thailand, United Kingdom and the United States of America. Australia was represented by the FRC Chairman and Secretary, the Chairman of the AASB, senior officers of the Australian Treasury and members of the accounting profession.

The Forum provided an opportunity for participants from the Asia-Pacific region to discuss: issues facing the IASB in the quest for global convergence and IFRS adoption; the nexus between the global financial crisis and convergence; the relevance of financial reporting to central banks and bank supervisors and the implications for financial reporting; ways to improve financial statement presentation to make the statements more useful to preparers, users, policy makers and regulators; increasing the role of Asia-Oceania in the IFRS setting process and active participation in the work of the IASB; and the Asia-Oceania IFRS adoption/convergence experiences, challenges and roadmaps.

Participants: reaffirmed their commitment to accelerate the convergence and adoption of IFRS as a set of high-quality global accounting standards in the Asia-Oceania region; agreed that stakeholders in Asia-Oceania need to be more proactive in ensuring their voice is heard by the IASB; agreed that policy makers (such as tax authorities) need to more actively engage the IASB in order to promote transparency and better align

policies and standards; agreed that the processes for setting international auditing standards and IFRS need to be better aligned; and suggested initiatives to advise key stakeholders on the rapid changes being made to IFRS.

A fifth meeting in the Regional Policy Forum series will be held in 2011 in Indonesia.

## **Asian-Oceanian Standards Setters Group**

In April 2009, a preparatory meeting of 12 standard setters in the Asia-Oceania regions agreed to establish the Asian-Oceanian Standards Setters Group (AOSSG) as a forum to promote the adoption of, or convergence with, IFRS in the region, support the IASB's effort to establish a single set of high-quality global accounting standards, coordinate positions of jurisdictions in the region and participation in the development of IFRS, improve the consistency and comparability of financial reporting standards in the region and enhance the quality of financial reporting of jurisdictions in the region. The FRC Chairman and the Acting Chairman of the AASB represented Australia at the preparatory meeting.

The first meeting of AOSSG was held in Kuala Lumpur, Malaysia, on 4-5 November 2009. The meeting, which was hosted by the Malaysian Accounting Standards Board, was attended by representatives of 21 standard setting bodies of the Asia and Oceania regions and the IASB. Australia was represented by Mr Kevin Stevenson, who is Chairman of the AASB and a member of the FRC.

AOSSG members adopted a MOU which formalised the establishment of AOSSG and sets out the following objectives for the Group: promoting the adoption of, and convergence with, IFRS by jurisdictions in the region; promoting consistent application of IFRSs by jurisdictions in the region; coordinating input from the region to the technical activities of the IASB; and cooperating with governments and regulators and other regional and international organisations to improve the quality of financial reporting in the region.

The FRC is fully supportive of the objectives adopted by the Group.

## **Japanese delegation**

A high-level business delegation from Japan visited Australia during September 2009 to investigate the adoption of IFRS in Australia. The delegation met with a large number of Australian stakeholders, including the FRC, AASB, ASIC, officials of the Australian Treasury and the Department of Finance and Deregulation, and business groups in Sydney, Canberra and Melbourne. The consensus that emerged in discussions with the delegation was that the adoption of IFRS in Australia had been a 'soft-landing' and that we should work to enhance Australian-Japanese cooperation on accounting standards in the context of seeking to build greater regional influence.

The meetings were particularly valuable in highlighting to the Japanese delegation the value of moving to IFRS. The delegation was informed that the most significant benefits had accrued to enterprises operating internationally, since there was the possibility of operating with a unified set of accounting principles, but that all entities had potentially gained – from an increase in transparency, a possible reduction in the cost of capital (or increased ease of raising funds offshore), and the adoption of what was generally a better and more comprehensive set of accounting standards. The delegation was also informed that, while most entities felt that there was no systematic increase in ongoing operating costs, there had been a significant one-off cost to transition to the new system. The changes to the treatment of brand names and other intangibles, and the introduction of the financial instruments standard were the areas where there had been the greatest adjustment costs arising from the transition to IFRS.

For the Japanese delegation, the shift to a principles-based system was a clear focus of interest, and a number of features of this were discussed: the general view was that while principles-based systems allowed a degree of flexibility in the interpretation of accounting standards, they did not lead to greater scope for fraud or opportunistic behaviour.

## **1.4 COOPERATION WITH NEW ZEALAND**

### **Single Economic Market outcomes framework**

On 29 August 2009, the Prime Ministers of Australia and New Zealand agreed on a framework of principles and a range of shared medium term practical outcomes for developing cross border initiatives. A key element within the framework is a deliberate move from consideration of purely national benefits in policy development, to consideration of the net trans-Tasman benefit.

Outcomes to be progressed between the two nations relating to financial reporting and audit matters include:

- ensuring that for-profit and not-for-profit entities respectively can use a single set of accounting standards to prepare only one set of financial statements in Australia and New Zealand;
- opening up the trans-Tasman market for audit services by allowing auditors registered in one country to operate as though they are registered in the other country; and
- ensuring that the financial reporting oversight and standards-setting bodies in Australia and New Zealand have functional equivalence.

The FRC in its deliberations on financial reporting matters has historically been mindful of New Zealand developments in its regulatory environment (see cross-memberships section below). Following the Prime Ministers' statement, the FRC has been alert to ensuring that focus is maintained on delivering the identified financial reporting outcomes and that the development of any proposed reforms considers the trans-Tasman dimension.

## **Trans-Tasman Accounting and Auditing Standards Advisory Group**

The FRC Chairman is a member of TTAASAG, which was established in 2004 to advise the Australian and New Zealand Governments and accounting and auditing standards setters on ways to reduce costs and improve efficiency by aiming for single sets of accounting and auditing standards to apply in both jurisdictions. TTAASAG also seeks to maximise the influence of Australia and New Zealand in the development of international accounting standards and international auditing and assurance standards, including the international standards setting processes supporting the development of those standards.

In 2009-10, issues considered by TTAASAG included:

- the Single Economic Market (SEM) outcomes framework agreed to by the Prime Ministers of Australia and New Zealand in August 2009 (see above);
- amending the Group's current Terms of Reference to reflect the principles enunciated by the Prime Ministers in their SEM statement. The Group also agreed that the current Terms of Reference should be re-stated to align with the terms of the outcome statements and to demonstrate a more ambitious, high-level role for the Group;
- proposed reforms to New Zealand's financial reporting framework, which would see the ASRB replaced by an External Reporting Board that would be responsible for overseeing the accounting and auditing standards-setting bodies;
- progress on Australia's and New Zealand's corporate reporting reforms, including noting that two measures contained in the Australian reforms would more closely align the Australian and New Zealand financial reporting frameworks by streamlining parent-entity reporting and replacing the profits test for paying dividends with a more flexible balance sheet solvency test.

## **Cross-memberships with NZ bodies**

Following its establishment in 2004, TTAASAG proposed that cross-membership between relevant standard setting and oversight bodies of Australia and New Zealand would be a desirable step in the process of reducing costs and improving efficiency of businesses operating in both jurisdictions. In 2008-09, TTAASAG reviewed the role of cross-appointees and concluded that they are contributing to the standard setting process by facilitating cooperation and communication.

The FRC Chairman has been a member of the ASRB throughout the period covered by this report. Mr Kevin Simpkins, Chairman of the ASRB, has been a member of the FRC since June 2009.

During 2009-10, another member of the FRC, Mr Kevin Stevenson, Chairman of the AASB, was a member of the NZ Financial Reporting Standards Board (FRSB), while Ms Joanna Perry, Chairman of the FRSB, was a member of the AASB.

## **1.5 OTHER INTERNATIONAL ENGAGEMENT**

### **IASC Foundation<sup>1</sup>**

The International Accounting Standards Committee (IASC) Foundation is an independent not-for-profit, private sector organisation committed to developing, in the public interest and through its standard-setting body, the IASB, a single set of high-quality, international financial reporting standards for general purpose financial statements. The Foundation has 22 Trustees, who have senior executive experience and who come from diverse geographical and professional backgrounds in both the private and public sectors.

In his capacity as a Trustee of the Foundation, the FRC Chairman attended Trustees' meetings in Amsterdam, New York, Rio de Janeiro and London during 2009-10. Costs associated with the FRC Chairman's attendance at these meetings are met by the Foundation.

Having an Australian as a Trustee of the Foundation provides significant benefits for Australia, as it enables issues of concern to us to be raised for consideration at meetings of the Foundation. It also alerts us to developments that may have consequences for Australia's financial reporting framework.

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<sup>1</sup> From 1 July 2010, the IASC Foundation has become the IFRS Foundation.

## **Visit to North America and Europe**

Between 29 September and 9 October 2009, the FRC Chairman and Secretary held meetings with a range of bodies from the accounting and auditing communities in Europe and North America. The visit was scheduled to coincide with the meeting of the IASC Foundation trustees in New York on 6-8 October.

Organisations with which meetings were held included: the IASB, the Financial Services Authority, UK Financial Reporting Council, the UK Accounting Standards Board and HM Treasury in London; the US Securities and Exchange Commission (SEC) and the US Public Company Accounting Oversight Board (PCAOB) in Washington DC; and the International Federation of Accountants in New York.



## **2 DOMESTIC ACTIVITIES**

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### **2.1 INTRODUCTION**

The FRC continued its active involvement in domestic accounting and auditing standards setting activities during 2009-10. Within Australia, the FRC's responsibilities in respect of accounting and auditing standards include: promoting the continued adoption of international best practice in accounting and auditing standard setting processes; and monitoring the operation of such standards to assess their continued relevance and their effectiveness in achieving their objectives.

Over the past year, the FRC has done this through meetings and other involvement with domestic stakeholders and interest groups and consideration of financial reporting issues in the public and private sectors (for example, GAAP/GFS harmonisation and differential financial reporting). In addition, the FRC considered a strategic plan for 2010-11 which will see work undertaken on a range of specific financial reporting-related projects during the course of the year.

### **2.2 STAKEHOLDER ENGAGEMENT**

The FRC's engagement with domestic stakeholders and other interest groups continues to be addressed in a number of ways, including through liaison between stakeholders and their respective nominees on the Council and presentations at FRC meetings on issues of relevance to the Council and its stakeholders.

During the period, the FRC Chairman met with a range of organisations, including accounting firms, the professional accounting bodies, industry groups and regulatory bodies.

Issues which the FRC considered during 2009-10 included:

- whether internal controls over financial reporting in Australian companies should be subject to greater regulation;
- action by the Water Accounting Standards Board in respect of water accounting, including the development of a water accounting conceptual framework, a preliminary water accounting standard and an associated model report.

The agendas of most FRC meetings make provision for Council members to raise issues of concern to their stakeholder bodies.

In addition, the FRC arranged a workshop on differential financial reporting and held a strategic planning session to consider the Council's activities during 2010-11. Further information on the workshop and planning session appears below.

### **2.3 PUBLIC SECTOR ACCOUNTING — GAAP/GFS HARMONISATION**

In December 2009, the FRC considered recent developments concerning the completion of the GAAP/GFS Harmonisation Project. The FRC focused on the AASB's tentative decision to develop the proposals in ED174 *Amendments to Australian Accounting Standards to facilitate GAAP/GFS Harmonisation for Entities within the GGS* into non-mandatory guidance (rather than an accounting standard).

In its consideration of the AASB's tentative decision, the FRC confirmed that the strategic direction it issued in December 2002, seeking the AASB to harmonise public sector accounts with the requirements of the Government Finance Statistics (GFS), was still relevant. The FRC therefore decided that the AASB's tentative decision would not satisfy that direction, because the non-mandatory nature of guidance would not meet the objectives of the strategic direction as it would not necessarily result in harmonisation of financial reporting with GFS in the general government sector.

The AASB Chairman was asked to inform the AASB of the FRC's views, and to work to meet the objectives of the strategic direction. Subsequently, at the AASB's February 2010 meeting, it was agreed that the AASB's staff would further develop their recommendations for the content of a standard focusing explicitly on improving the usefulness of general purpose financial statements of entities within the general government sector. The FRC was informed that such a standard would go significantly beyond the proposals in the previous exposure draft and would likely require further due process through a new exposure draft.

### **2.4 DIFFERENTIAL FINANCIAL REPORTING**

The FRC held a workshop in August 2009 to consider a range of issues including: the appropriateness of Australia's current differential reporting framework; the IASB's July 2009 release of an accounting standard for small and medium-sized entities (known as IFRS for SMEs); and the potential for that standard to play a role in Australia's differential reporting framework. At the workshop it was agreed that a discussion paper would be prepared for consultation with stakeholders and other interested parties on any possible reform initiatives.

In December 2009, the AASB released a draft consultation paper that proposed a reduced disclosure approach to SME reporting. Subsequently, in February 2010, the AASB released an exposure draft proposing lower disclosure requirements for entities

that are not public interest entities. The proposal envisaged entities being subject to the recognition and measurement contained in full IFRS, but with reduced disclosure requirements generally based on the IASB's IFRS for SMEs standard.

Following consideration of public submissions, the AASB decided that the revised differential reporting regime should be established in two stages:

- In the first, the Reduced Disclosure Regime should be introduced as a second Tier of reporting requirements for preparing general purpose financial statements. The aim of this stage is to attend to the immediate reporting needs of entities that currently apply full IFRSs but which find the disclosures required by them burdensome. Under this stage, the reporting entity concept will continue to be used for differential reporting purposes and a separate application standard will clarify the application of the two Tiers.
- In the second stage, the Board agreed that further research should be carried out about the potential impact on those entities currently preparing special purpose financial statements if they were to be required to produce general purpose financial statements.

The differential reporting framework will be operative for annual reporting periods beginning on or after 1 July 2013. Early adoption will be possible for organisations with annual reporting periods beginning on or after 1 July 2009.

The FRC supports the action taken by the AASB to reduce the regulatory burden on those entities that are not publicly accountable.

## **2.5 STRATEGIC PLANNING**

The FRC held a strategic planning session as part of its May meeting. The purpose of the session was to: look to the future of the FRC; and determine what the Council may seek to deliver in the next 12 months.

Matters identified for further consideration by the FRC during 2010-11 included:

- a review of Australia's regulatory financial reporting environment;
- the increasing complexity of corporate reporting;
- financial reporting issues arising out of the global financial crisis; and
- risk reporting.

These matters will be considered at meetings of the Council held during the remaining months of 2010 and the first half of 2011. Actions taken in respect of the matters will be

reported in Bulletins issued by the FRC after each meeting and in the Council's next annual report.

## 2.6 OTHER FRC ACTIVITIES

In November 2009, the Group of 100 sent a paper, *Less is More*, which was developed with FRC input, to the IASB to assist it determine the type and nature of disclosures that should be included in a financial report. This work is expected to be influential in setting disclosure requirements and determining the relevance of information to users, particularly shareholders and other capital providers. The work proposes that disclosures should be equally understandable to the reasonably knowledgeable user and the sophisticated expert and that disclosures should provide comparability and consistency across both peer groups and reporting periods to allow for meaningful analysis by users.

On 5 March 2010, the FRC Chairman released a Treasury consultation paper 'Audit Quality in Australia: A Strategic Review'. The paper identifies the drivers of audit quality in Australia and assesses whether any measures should be taken to address any real or perceived threats to these drivers of audit quality. Treasury received eighteen submissions in response, with seventeen public submissions, and one confidential submission. The public submissions are available on the Treasury website.

## 2.7 VISITING SPEAKERS

Mr Tim Flynn, Chairman of KPMG International and KPMG LLP, its US member firm, delivered the 2010 Ken Spencer Memorial Lecture<sup>2</sup> in Melbourne on 2 March 2010. His lecture was titled '*Restoring Trust and Building Confidence*' and dealt with a broad set of issues arising out of the global financial crisis.

Professor Arnold Schilder, Chairman of the International Auditing and Assurance Standards Board, visited Australia in early May 2010 and attended a number of meetings, lectures and other functions arranged by the Chairman of the Auditing and Assurance Standards Board (AUASB). The FRC Chairman met with Professor Schilder on 11 May, while other representatives of the FRC later met with him for a working lunch and a discussion about the challenge of defining and recognising audit quality, and its relevance to the user community. In the evening Professor Schilder presented a public lecture on '*Future of Auditing: Audit Quality, Implementation and Innovation*'.

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2 The lecture commemorates the memory of Kenneth H Spencer, a former partner in the Melbourne office of KPMG, who passed away in March 2004. At the time of his death, Mr Spencer was a Trustee of the IASC Foundation and a member of the FRC. He had previously been Chairman of the AASB from 1995 to 1999.

## **3 OVERSIGHT OF AUSTRALIAN STANDARDS SETTING**

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### **3.1 INTRODUCTION**

Under the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the FRC's functions are to provide broad oversight of the processes for setting accounting and auditing standards in Australia and to give the Minister reports and advice about these processes. Specific accounting and auditing standard setting functions for which the FRC was responsible in 2009-10 are contained in subsections 225(2) and (2A) of the ASIC Act. An outline of each of these functions is provided in this section of the report in conjunction with information about the performance of the function.

### **3.2 APPOINTMENT OF MEMBERS TO BOARDS**

The ASIC Act provides that the FRC is responsible for appointing the members of the AASB and AUASB (other than the Chairmen, who are appointed by the Minister). In addition, the Act provides that the members of the Boards (other than the Chairmen) hold office on the terms and conditions determined by the FRC.

The FRC is assisted in the performance of these functions by a Nominations Committee which, among other things, is responsible for seeking expressions of interest from persons interested in being considered for appointment to either the AASB or AUASB and interviewing and evaluating candidates on the basis of merit. The members of the Nominations Committee during 2009-10 are listed in Appendix B.

In 2009-10, for the first time in a number of years, the FRC did not advertise seeking expressions of interest from persons interested in being appointed to one of the Boards. The Chairmen of both the AASB and AUASB informed the FRC that they were satisfied with the work currently being done by their respective Boards and were supportive of the retiring members being offered reappointment for another three years.

Accordingly, on 21 September 2009, the FRC approved the following re-appointments for terms commencing on 1 January 2010 and ending on 31 December 2012:

- AASB: Ms Sue Highland, Ms Kris Peach and Ms Joanna Perry; and
- AUASB: Ms Dianne Azoor Hughes and Mr Clive Mottershead.

One of the members re-appointed to the AUASB, Mr Clive Mottershead, subsequently found it necessary to resign from the Board with effect from 31 March 2010. The filling of the vacancy created by Mr Mottershead's resignation was being considered by the Nominations Committee at the time this report was being prepared.

As at 30 June 2010, the AASB had 13 members while the AUASB had 12 members.

In conjunction with its role of making recommendations to the Council about appointments to the Boards, the Nominations Committee also conducts an annual peer review process for both Boards. The review process is an important tool for management and accountability purposes and assists in ensuring Council's decisions about the membership and operation of both Boards are timely and well informed. The peer review process also provides an important vehicle for a constructive and professional dialogue between individual Board members and their respective Chairmen.

### **3.3 GIVING ADVICE OR FEEDBACK TO THE BOARDS AND THEIR OFFICES**

The FRC's functions include giving the AASB and AUASB advice or feedback on their priorities, business plans and procedures and giving the Offices of the AASB and AUASB advice or feedback on their budgets and staffing arrangements (including level, structure and composition of staffing).

During the period under review, the FRC monitored the priorities, business plans, procedures, budgets and staffing arrangements of the Boards and their respective Offices using the reports provided to each meeting of the FRC by the Chairmen of the Boards. In addition, these issues are considered during periodic discussions between the FRC Chairman and the Chairmen of the Boards about the operation of the Boards.

The FRC did not provide any advice or feedback under paragraph 225(2)(b) or (ba) or (2A)(b) or (ba) of the ASIC Act during the period to which this report relates.

### **3.4 BROAD STRATEGIC DIRECTIONS OF BOARDS**

The FRC's functions include determining the broad strategic directions of the AASB and AUASB. The FRC has developed guidelines to be applied in the development of any strategic directions that are issued to the Boards (see [http://www.frc.gov.au/guidelines/strategic\\_directions.asp](http://www.frc.gov.au/guidelines/strategic_directions.asp)). The guidelines envisage that, in developing and issuing new and revised strategic directions, the Council will take into account:

- the Australian Government's stated policies and priorities;

- relevant international and domestic considerations impacting on the setting of accounting or auditing standards; and
- the public interest in the context of the Australian economy.

Since its establishment, the FRC has made three determinations concerning the broad strategic directions of the AASB and AUASB. These directions sought to achieve the following key outcomes:

- to require the AASB to work towards the adoption in Australia of accounting standards that are the same as those issued by the IASB, to ensure their applicability to *Corporations Act 2001* (Corporations Act) entities for accounting periods beginning on or after 1 January 2005 (Direction approved 5 September 2002);
- to require the AASB to pursue as an urgent priority the harmonisation of GFS and GAAP reporting (Direction issued 18 December 2002); and
- to require the AUASB to develop Australian auditing standards that have a clear public interest focus and are of the highest quality and to use, as appropriate, International Standards on Auditing issued by the International Auditing and Assurance Standards Board as a base from which to develop the Australian standards (Direction approved 4 April 2005).

Each of these directions is still current.

During 2009-10, the FRC monitored the activities of both Boards and formed the view that there was no need to issue any new directions or amend the existing directions.

### **3.5 DEVELOPMENT OF INTERNATIONAL ACCOUNTING AND AUDITING STANDARDS**

The ASIC Act confers on the FRC the following functions associated with the development of international standards:

- monitoring the development of international accounting and auditing standards and the accounting and auditing standards that apply in major international financial centres; and
- furthering the development of single sets of accounting and auditing standards for world-wide use with appropriate regard to international developments.

Information about international developments was obtained by the FRC Secretariat during the year through monitoring media reports and the internet websites of overseas organisations (including public-interest oversight bodies, standards setters

and regulatory agencies). This information is used to prepare a summary of key international financial reporting developments which is circulated to Council members on a regular basis.

In addition, information about international developments in the setting of accounting and auditing standards was obtained by the FRC Chairman and FRC Secretary during a visit to Europe and North America in September and October 2009.

During 2009-10, the FRC Chairman continued to be involved in activities associated with furthering the development of single sets of accounting and auditing standards for world-wide use. Apart from actions taken in his capacity as a Trustee of the IASC Foundation, the FRC Chairman participated in TTAASAG, the fourth IFRS Regional Policy Forum and a high-level business delegation from Japan investigating the adoption of IFRS in Australia. Further information about these activities appears in section 1 of the report.

### **3.6 MONITORING AUSTRALIAN DEVELOPMENTS**

The FRC has the following specific responsibilities in respect of Australian accounting and auditing standards:

- promoting the continued adoption of international best practice in the Australian accounting and auditing standard setting processes if doing so would be in the best interests of both the private and public sectors in the Australian economy; and
- monitoring the operation of accounting and auditing standards to assess their continued relevance and their effectiveness in achieving their objectives in respect of both the private and public sectors of the Australian economy and the effectiveness of the consultative arrangements used by the AASB and AUASB.

In 2009-10, the FRC monitored the operation of accounting and auditing standards through reports presented at FRC meetings by the Chairs of the AASB and AUASB, stakeholder reports provided to FRC meetings by Council members, meetings between the FRC Chairman and stakeholder bodies and media reports about the operation of accounting and auditing standards.

The FRC's major interest during this period has been the AASB's work on GAAP/GFS harmonisation project and the adoption of a differential reporting regime to reduce the regulatory burden the use of full IFRS for the preparation of financial statements imposed on small and medium-sized entities that are not publicly accountable. Further information about these activities appears in section 2 of the report.

### **3.7 FUNDING OF THE BOARDS**

During 2009-10, the ASIC Act was amended to relieve the FRC of the following obligations concerning the funding of the AASB and AUASB:

- seeking contributions towards the costs of the Australian accounting and auditing standards setting processes; and
- monitoring the level of funding, and the funding arrangements, for those processes.

Since 1 July 2008, the Boards have been subject to the Australian Government's normal budget funding processes, which are developed by the portfolio department and are subject to the oversight of the Treasurer through the Expenditure Review Committee.

Information about the funding of the Boards in 2009-10 is contained in the Boards' own annual reports for that year.



## 4 MONITORING AUDITOR INDEPENDENCE

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### 4.1 INTRODUCTION

The ASIC Act provides that the FRC's functions are to monitor the effectiveness of auditor independence requirements in Australia and to give the Minister reports and advice about this matter.

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

- Divisions 3 and 5 of Part 2M.4 of the Corporations Act, which set out the requirements that have to be satisfied by the auditors of those entities that are subject to the audit requirements of the Act;
- Auditing Standard ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*, which was approved by the AUASB in October 2009 and is operative for financial reporting periods commencing on or after 1 January 2010<sup>3</sup>;
- Auditing Standard ASQC 1 *Quality control for firms that perform audits and reviews of financial reports and other financial information, and other assurance engagements*, which was approved by the AUASB in October 2009 and is operative from 1 January 2010;
- Section 290 of the *Code of Ethics for Professional Accountants* (APES 110), which was issued by the Accounting Professional and Ethical Standards Board (APESB) in June 2006 and amended in December 2007 and February 2008; and
- APES 320 *Quality control for firms*, which was originally issued by the APESB in May 2006 and reissued in May 2009.<sup>4</sup>

Under the Corporations Act, all disclosing entities, public companies (except some companies whose members' liability is limited by guarantee<sup>5</sup>), large proprietary

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3 When operative, this standard replaces Auditing Standard ASA 220 Quality control for audits of historical financial information, which was issued by the AUASB in April 2006 and was operative for financial reporting periods commencing on or after 1 July 2006.

4 The reissued standard is effective from 1 January 2010, although early adoption is permitted.

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

companies<sup>6</sup> 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.

To complement the legislative and professional requirements on independence of auditors, appropriate institutional arrangements have been put in place to monitor compliance with those requirements and, where necessary, take appropriate follow-up action. The principal organisations making up these institutional arrangements are ASIC, the Australian Securities Exchange (ASX), the professional accounting bodies (the ICAA, CPA Australia and the NIA), APESB, the Companies Auditors and Liquidators Disciplinary Board (CALDB) and the FRC.

## **4.2 SYSTEMS AND PROCESSES OF AUSTRALIAN AUDITORS**

The ASIC Act requires the FRC to monitor and assess the nature and overall adequacy of the systems and processes used by audit firms to ensure compliance with auditor independence requirements.

In 2009-10, the FRC performed this function by gathering information from ASIC under the terms of its MOU with that body, by reviewing reports published by the ICAA and by requesting information from the professional accounting bodies under the terms of its MOUs with those bodies.

On the basis of its work during the period covered by this report, the FRC formed the view that the systems and processes used by audit firms to ensure compliance with auditor independence requirements are working effectively. Nevertheless, the FRC is disappointed to note that the inspections by ASIC continue to reveal that some firms inspected for the first time need to make improvements in their systems and processes to ensure that their systems are robust and comply with all legislative and professional requirements.

During 2010-11, the FRC will consult with ASIC and the professional accounting bodies about measures that could be adopted to convey to smaller firms the importance of having robust systems and processes that comply with all applicable auditor independence requirements.

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

## Report from ASIC

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

ASIC's 2009-10 report to the FRC summarises ASIC's observations and findings in relation to the independence systems and processes of selected firms where inspections were either in progress on 1 July 2009 or commenced after that date and were substantially completed by 30 June 2010. The report by ASIC has constituted a key source of information for the FRC with respect to its responsibilities in this area during 2009-10.

In addition to the report to the FRC for the period 1 July 2009 to 30 June 2010, ASIC also issued a public report on its audit inspection program in March 2010 which covered the inspections of 19 firms substantially completed in the period between 1 January 2008 and 30 June 2009. A copy of the public report is available on the ASIC website ([www.asic.gov.au](http://www.asic.gov.au)).

For the purpose of the report to the FRC on the 2009-10 audit inspection program (and also the public report referred to above), ASIC has divided Australian accounting firms into three broad groups:

- National Firms consisting of national partnerships that are members of global networks with multiple offices. Currently there are six National Firms operating in Australia: Deloitte Touche Tohmatsu, Ernst & Young, Grant Thornton, KPMG, PricewaterhouseCoopers and RSM Bird Cameron;
- Network Firms consisting of individual offices of firms that are members of international associations. Currently there are 11 of these in Australia: BDO Australia, Bentleys, Hall Chadwick, HLB Mann Judd, Moore Stephens, Nexia (Australian member firms), Pitcher Partners, PKF Australia, UHY Haines Norton, WHK Horwath and William Buck; and
- Smaller Firms consisting of up to 100 firms with a small number of audit partners that audit a limited number of listed entities.

During the year ended 30 June 2010, ASIC completed inspections of 16 selected firms. The following table summarises the firms inspected during the period and whether it was the first inspection or a subsequent inspection of a firm that had already been subject to one or more inspections in prior periods.

**Table 1 — Summary of firms inspected by ASIC during 2009-10**

<b>Firms</b>	<b>Number of firms inspected for the first time</b>	<b>Number of firms inspected for the second or subsequent time</b>	<b>Total</b>
National Firms	1	4	5
Network Firms	4 <sup>7</sup>	-	4
Smaller Firms	7	-	7
Total	12	4	16

Two of the inspections were conducted jointly with the PCAOB. These were undertaken under an agreement entered into by ASIC to assist the PCAOB to ascertain compliance by Australian auditors with the Sarbanes Oxley Act of 2002.

Collectively, the 16 firms inspected by ASIC audit approximately 56 per cent by number and 57 per cent by market capitalisation of the 300 largest entities listed on ASX (S&P/ASX 300). The National Firms represent the larger proportion, with responsibility for the audit of 54 per cent by number and 57 per cent by market capitalisation of the S&P/ASX 300<sup>8</sup>.

ASIC's observations and findings for its inspections of the 16 firms varied amongst the firms inspected. Common themes were identified between the different groups of firms but the findings differed. In ASIC's view, the differences are partly due to the number of times it has previously inspected the firms and the fact that the nature of the systems used in firms may vary depending on the size of the firm. Overall, the firms have shown commitment towards addressing the observations and findings ASIC raised in its individual inspection reports.

### **National firms**

Five national firms were inspected during 2009-10: three were inspected for the fifth time, one for the third time and one for the first time.

As part of its inspection program, ASIC found that during the year a national firm identified two breaches of the auditor rotation requirements of sections 324DA and 324DB of the Corporations Act. The breaches, which both arose out of the audit of the same listed client, involved one partner playing a significant role in the audit for eight successive financial years (two as engagement quality control reviewer and six as the lead partner) and another partner playing a significant role in the audit for six

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7 These firms were inspected for the first time as networks under the revised definition of a network firm (in APES 110). Two member firms of one of these networks had been inspected in prior periods.

8 The result of the analysis of audits undertaken by the firms is notably lower than that reported in the FRC's 2008-09 annual report because one of the national firms was not inspected during 2009-10. Source: Morningstar DatAnalysis as at 30 June 2010.

successive financial years (as engagement quality control reviewer). The firm informed ASIC that: the breaches occurred as a result of a misunderstanding of the rotation requirements when the audit client had been suspended from quotation on the ASX for a period of time; and once the rotation breaches were identified a new lead partner and engagement quality control reviewer were assigned to the client to remedy the situation. ASIC has informed the FRC that, in its view, the breaches of the auditor rotation requirements of the Act are significant contraventions and that the auditor should have notified ASIC in accordance with the requirements of section 311 of the Act, but failed to do so. The FRC notes ASIC's view about the seriousness of these breaches.

ASIC has also informed the FRC that a breach of the auditor independence requirements was identified and reported to it by a national firm. The breach arose from a new partner who was an officer of a listed client of the firm in the 12 months immediately preceding the financial year in which he was admitted as a partner of the firm and who held direct financial interests in the listed audit client<sup>9</sup>. The person has ceased to hold the position of partner of the national firm and the firm issued a qualified section 307C declaration. The firm has also implemented a procedure to ensure that independence clearances are obtained prior to finalising new partnership agreements.

ASIC's report to the FRC also contained a number of observations concerning national firms' independence policies and processes, testing of independence systems and human resources issues. These observations included:

- *Independence policies and processes:* ASIC's inspection highlighted areas where three of the national firms can still enhance the oversight and monitoring of their independence systems and processes:
  - one firm needs to inject more rigour into its established independence system, as the system failed to prevent, detect and report potential auditor rotation breaches in a timely manner. The firm also needs to improve its documentation of independence consultations to better evidence that all the relevant facts are fully considered to ensure appropriate action is taken by the firm;
  - at a second firm, there is scope to improve the timeliness of updating the prohibited securities lists; and

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<sup>9</sup> The FRC has been advised that the partner did not provide any audit or non-audit services to the audit client. However, the partner was from the same office as that providing the assurance services to the audit client and, as stated in paragraph 290.117 of APES 110, 'the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level'.

- a third firm has yet to develop formal independence policies that reflect the requirements of sections 342CI and 324CK of the Act. In addition, the firm needs to ensure that its prohibited securities list includes all the subsidiaries and related corporations of consolidated entities on the list and that it sets up a national database to record and document independence consultations.
- *Testing independence systems:* ASIC reported that one national firm has not yet commenced the testing of its independence systems. However, the other national firms visited tested their independence systems during the reporting period. ASIC noted that at three firms that had previously tested their independence systems, the recent testing results showed a reduction in the number of incidences of non-compliance with each of the firm's independence policies. Finally, ASIC observed that one firm did not communicate the results of its independence testing to its partners and staff on a timely basis.
- *Human resources:* At two of the national firms inspected, ASIC found that the linkage between independence and the partner evaluation and compensation process was not always clear. One firm, in ASIC's view, did not give sufficient weight to the importance of independence and ethics in the overall partners' performance appraisal process while at the other firm independence and commitment to ethical principles were not specifically covered as part of the partner evaluation and compensation process.

### **Network firms**

ASIC has informed the FRC that four of the network firms were inspected for the first time during the reporting period. Observations made by ASIC as a result of these inspections include:

- *Breach of specific audit independence requirements of the Act:* A breach of the auditor independence requirements of sections 324DA and 324DB of the Act was identified by ASIC during its inspection of one network firm. An audit partner played a significant role in the audit of a listed client for a period in excess of five years. In addition, the firm neither disclosed the contravention in its section 307C auditor's independence declaration nor did it notify ASIC of the contravention under section 311 of the Act. Once the firm was aware of the breach of the rotation requirements, the audit partner was rotated off the engagement.
- *Independence policies and processes:* All of the firms inspected have policies and processes in place to facilitate compliance with the independence requirements of the Act and professional standards. However, the completeness and adequacy of the independence policies and processes varied, reflecting the nature or maturity of the network structure of the firms. ASIC formed the view that the independence policies and processes of the network firms need improvement to ensure that the policies and processes are consistent with the Act and professional standards and applied consistently across the member firms of the network.

One network firm inspected needs to provide sufficient resources for the development, documentation and support of its independence policies and processes to ensure its personnel understand the independence requirements with which they are required to comply. Another network firm should ensure that it monitors and maintains independence from its international network.

- *Auditor rotation:* ASIC formed the view that one inspected firm needs to implement processes to satisfy the partner rotation requirements of the Act, while another firm needs to improve its scheduling and monitoring of partner rotation plans and ensure that its member firms are able to manage the rotation of partners for any existing audit clients that become listed.
- *Testing of independence systems:* None of the network firms inspected during the reporting period had, at the time they were inspected, commenced testing their independence systems and processes to ensure that they are meeting the requirements of the Act and professional standards. The FRC agrees with ASIC's view that, without an appropriate testing program, firms can only place limited reliance on the effectiveness of their independence systems and processes.
- *Evaluation of independence threats:* In ASIC's view, there is scope for all of the network firms inspected to improve their processes to enable potential threats to independence to be identified and evaluated for appropriate action. It noted that at one firm the prohibited securities list was not up-to-date, while three firms need to improve their documentation of consultations about potential threats to independence and how those threats have been mitigated to an acceptable level. ASIC has suggested that the firms should establish a database or register to record independence consultations on a network basis.
- *Human resources:* ASIC has noted that one network firm does not specifically include independence and commitment to ethical principles in its partner evaluation and compensation process. In ASIC's view, including independence as an explicit factor in the partner evaluation and compensation process would provide a clear message from a firms' leadership about the importance of independence.

### Smaller firms

Seven smaller firms were inspected during the reporting period. ASIC has informed the FRC that its consideration of smaller firms' compliance with the independence requirements of the Corporations Act is limited to high-level enquiries with the firms' leadership and independence-related matters on the audit engagement file selected for review. In addition, ASIC has also informed the FRC that in conducting these inspections, and in determining its observations and findings, it is conscious of the size and nature of the smaller firms.

ASIC found that most of the smaller firms inspected had a basic level of independence policies and processes in place. However, its inspections showed areas that could be improved to ensure that firms are complying with the legal and professional independence requirements.

Observations made by ASIC as a result of its inspections of the smaller firms included:

- one firm had not developed formal policies and procedures for the completion of annual independence declarations;
- one firm needs to ensure that the subject matter of its independence policy is consistent with the Act; and
- one firm needs to improve communication to staff regarding the requirements of its independence policy and the appropriate forms to be used to document the evaluation of potential independence threats and the resolution of the potential threats.

#### **Other auditor independence matters noted by ASIC**

ASIC has also provided the FRC with information about other auditor independence issues that it became aware of outside its regular inspection program. In brief, these issues included:

- *Conflicts of interest:* ASIC received notification from a network firm that four conflict of interest situations involving breaches of legal and professional independence requirements had arisen. In each case, the firm ceased to be the auditor of the client as a result of the expiry of the 21 day period specified in subsection 327B(2B) of the Corporations Act.
- *Consent to resign as auditor:* ASIC received applications from eight auditors (four from smaller firms, three from national firms and one from a network firm) seeking consent to resign from an audit at a time other than the annual general meeting. In each of the cases, the auditor claimed to have lost independence as a result of one of the conflict of interest situations that are identified in the Corporations Act or professional standards. ASIC consented to the resignation of the auditor in six cases, while in the other two cases the audit appointment ceased because of the expiry of the 21 day period specified in subsection 327B(2B) of the Corporations Act.
- *Relief from the auditor rotation requirements:* Under subsection 342A(1) of the Corporations Act, ASIC can extend the rotation period in specific cases by one or two years after receiving an application from the auditor. During the period under review, ASIC received two applications from auditors seeking an extension of the rotation period under the Act. In one case, involving a misunderstanding of the rotation requirements, the application was refused as no unreasonable burden on either the company or the auditor was evident. In the second case, the

resignation of one partner and the death of another left a firm with only one partner who was a registered company auditor. ASIC concluded that requiring the remaining auditor to follow the rotation provisions of the Act would cause an unreasonable burden and granted relief so that the applicant could play a significant role in the audit for one more year.

- *Outcome of enforcement activity:* ASIC's 2009 report to the FRC noted that the CALDB found, in relation to a matter referred to it by ASIC, that the respondent had contravened the independence requirements of the Act. However, the respondent filed an application for a review of the CALDB's decision by the Administrative Appeals Tribunal (AAT). This was subsequently dismissed after the respondent withdrew his AAT application. Consequently, in November 2009, the CALDB published its decision that it had ordered the registration of the respondent to be cancelled.

### **4.3 QUALITY REVIEW PROGRAMS AND DISCIPLINARY PROCEDURES OF PROFESSIONAL ACCOUNTING BODIES**

Under the ASIC Act, the FRC is required to monitor and assess the nature, overall adequacy and effectiveness of: the systems and processes used by the professional accounting bodies for planning and performing quality assurance reviews of audit work undertaken by Australian auditors to the extent that those reviews relate to auditor independence requirements; the responsive action taken by auditors who have been subject to such reviews; and the action taken by the professional accounting bodies to ensure that auditors are responding appropriately. In addition, the FRC is required to monitor and assess the nature and overall adequacy of the investigation and disciplinary procedures of the professional accounting bodies as those procedures apply to Australian auditors.

During 2009-10, the FRC met these requirements by seeking relevant information from the professional accounting bodies and reviewing publicly available material issued by those bodies.

On the basis of information provided by the professional accounting bodies, the FRC did not become aware of any deficiencies in either the systems or processes used by the bodies for planning and performing quality reviews of audit work, or in the overall adequacy of the professional accounting bodies' investigation and disciplinary procedures.

## Quality review programs

### ICAA

ICAA members who hold a Certificate of Public Practice (CPP) are required to undergo the Quality Review Program in accordance with the policies and procedures governing the operation of the Program. The ICAA has informed the FRC that the Program has been designed to assess whether members in public practice have the appropriate quality control policies and procedures in place to comply with professional standards and regulatory requirements.

All practices that sign off on audits requiring registered company auditor (RCA) registration are reviewed at least once every three years (previously these practices were reviewed every five years, unless the practice audited public listed companies). All other practices (including those with an RCA but not conducting RCA audits) are reviewed once every five years. Information provided by the ICAA indicates that during the year ended 30 June 2010, it completed reviews of 456 practices with 80 per cent of the review reports recording either no departures from professional standards or departures from professional standards that are not classified as serious.

The ICAA divides the group of practices that conduct audits into two key types: those that conduct audits under the requirements of the Corporations Act; and those that conduct other types of audits. The reviews conducted during 2009-10 found that one per cent of the practices in each category had no departures from professional standards. All other practices had departures from professional standards, although these departures were not classified as serious for 73 per cent of the practices that conduct Corporations Act audits and 81 per cent of the practices that undertake other types of audits.

The ICAA has informed the FRC that its main concern continues to be a lack of documentation in relation to the audit opinion issued or insufficient documentation in a particular audit area. The ICAA noted that, while the substantial majority of files included sufficient audit evidence to support the conclusions reached, there were some instances where this was not adequately documented. Where documentation was inadequate, the auditor had failed to document all the work they had done to reach their conclusions.

In the area of auditor independence, the following areas of non-compliance with the requirements of APES 110 *Code of Ethics for Professional Accountants* were noted:

- no documentation or inadequate documentation when considering threats to independence (10 per cent of the 456 practices reviewed);
- appropriate safeguards were not adequately applied when carrying out auditing and accounting functions for a client (11 per cent of practices reviewed); and

- auditing the self-managed superannuation fund of a partner in their practice (5 per cent of practices reviewed).

The ICAA has informed the FRC that during 2009-10 it undertook a number of initiatives to assist members meet quality control and professional standards. One of these initiatives included writing in July 2009 to 80 auditors (excluding major and mid-tier firms) who conducted audits of listed public companies alerting them to the rotation requirements. The letter resulted in two auditors identifying that they were not in compliance with audit rotation requirements, and they subsequently addressed their non-compliance.

The FRC also notes that the ICAA's 2009-10 Annual Report on the Quality Review Program includes a thought leadership paper entitled *Quality Review: past present and future*<sup>10</sup> which examines the past, present and future trends of quality review, both in Australia and internationally. The paper details the major stakeholders and encourages thought leadership debate on key issues, actions and directions of quality review and that of the ICAA's Quality Review Program. During 2010-11, the FRC intends giving consideration to the issues raised in the ICAA's thought leadership paper with a view to providing comments to the ICAA.

### **CPA Australia**

CPA Australia has advised the FRC that as at 30 June 2010, 5,685 of its members held a CPA Australia Public Practice Certificate (PPC) while 1,133 held an ICAA Practice Certificate. All members who hold a PPC are subject to CPA Australia's Quality Assurance (QA) program. There are 736 members holding a PPC who are registered company auditors, a 2 per cent decrease on the past reporting year.

CPA Australia's QA program adopts a cyclical, risk assessment approach to selecting members for review. Members in public practice are reviewed every four to five years, with the exception of those members whose previous review identified departures from professional standards or a breach of an auditing standard. Members whose reviews have identified minor departures are reviewed again after three years. Members whose review outcomes identified significant non-compliance issues are reviewed again in the following year. Any public accounting service offered by a member is reviewed using a specific questionnaire which relates to the discipline in which they practise.

In 2009-10, the reviews conducted under CPA Australia's QA program found that 83 per cent of those reviewed were either fully compliant or had only minor departures from professional standards.

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10 This paper can be accessed at: <http://www.charteredaccountants.com.au/files/documents/0710-16QualityReviewThoughtLeadership-FA.pdf>

During 2009-10, 103 breaches of auditor independence requirements were identified, with the vast majority relating to audits of Self Managed Superannuation Funds (SMSFs). No breaches of auditor independence requirements by RCAs were identified.

In 2010-11, over 1,100 members have been selected for a QA review, with 203 of these members being RCAs.

## **NIA**

The NIA has informed the FRC that it requires all members who are issued with a PPC to undertake a Quality Assurance Review (PPQA) every three to five years. Members who are Australian auditors must be reviewed every three years.

In the period 1 July 2009 to 30 June 2010, the NIA undertook over 500 PPQA reviews of PPC members. The NIA has advised that, to the best of its knowledge, none of the reviews undertaken during this period involved an Australian auditor.

The NIA has also informed the FRC that it has a policy that any joint members (that is, those who are a CPA Australia or ICAA member) who have been subject to a PPQA by their other body in the last two years are exempt from the NIA PPQA. The purpose of this is to avoid the member being excessively audited on the same issue.

## **Disciplinary procedures**

The professional accounting bodies have provided the FRC with the following information concerning disciplinary matters during the year ended 30 June 2010:

- The ICAA has reported three disciplinary cases involving a breach of the Institute's auditor independence requirements. Each of the matters arose from a referral by the Australian Taxation Office (ATO) and related to the audit of SMSFs. Details of these cases, which resulted in each of the members being severely reprimanded by the Professional Conduct Tribunal, are available on the Institute's website.
- CPA Australia has advised that its Disciplinary Tribunal made three adverse findings against members relating to auditor independence. All of these adverse findings related to audits of SMSFs. There were no disciplinary actions taken against RCAs in respect of auditor independence. The outcomes of all professional conduct complaints heard by a Disciplinary Tribunal have been published on CPA Australia's website.
- The NIA has informed the FRC that it has not taken any disciplinary action in 2009-10 against any members who have identified themselves as Australian auditors. The NIA has also advised that it did not investigate any complaints against members who are RCAs in relation to the NIA's independence requirements. However, the NIA did receive a number of referrals from the ATO

in relation to potential breaches of the audit independence requirements as they apply to SMSF auditors (approved auditors). The NIA received five complaints from the ATO in relation to approved auditors with respect to breaches of the auditor independence requirements. Four of those members accepted that they had breached the independence requirements and undertook not to do SMSF audits. One complaint was referred to the Disciplinary Tribunal. That member was found to have breached the independence requirements and was censured.

None of the professional accounting bodies is aware of the referral of any members to the CALDB during the year ended 30 June 2010 for a breach of auditor independence requirements.

#### **4.4 TEACHING OF ETHICS BY THE PROFESSIONAL ACCOUNTING BODIES**

The ASIC Act requires the FRC to promote, and monitor the adequacy of, the teaching of professional and business ethics by, or on behalf of, the professional accounting bodies to the extent to which the teaching of those subjects relates to auditor independence.

During the period under review, the FRC continued to monitor the adequacy of the teaching of ethics by obtaining relevant information from the professional accounting bodies. On the basis of the information supplied by the bodies, the FRC is satisfied that the teaching of ethics by each of the bodies continues to be adequate.

#### **4.5 AUDIT-RELATED DISCLOSURE REQUIREMENTS**

The FRC is required by the ASIC Act to monitor the overall compliance by companies, registered managed investment schemes and disclosing entities with audit-related disclosure requirements of the Corporations Act and the accounting standards. A summary of these requirements is provided at Appendix D.

The MOU that the FRC has entered into with ASIC provides for ASIC to give the FRC regular reports identifying matters arising from its financial reporting or auditor surveillance activities in relation to compliance by auditors and companies with the independence disclosure requirements in Part 2M.3 of the Corporations Act. The MOU with the ASX also provides for that body and the FRC to exchange information.

No information was received by the FRC during 2009-10 indicating that there had been substantive non-compliance with the audit-related disclosure requirements of the Corporations Act and the accounting standards.

ASIC has informed the FRC that its financial reporting surveillance program for financial years of entities ending on 30 June 2009 and 31 December 2009 included examination of independence declarations under section 307C of the Corporations Act for about 430 listed entities. ASIC found that one of these declarations was not signed by the person making it as required by paragraph 307C(5)(b) of the Act. Section 307C independence declarations were also examined as part of ASIC's 2009-10 audit inspection program. Other than one auditor rotation breach noted elsewhere in this section of the report, no further exceptions were identified from this process.

The ASX has also informed the FRC that its technical review of financial reports lodged with it included an examination of the form and location in the financial reports of the auditor independence declarations required under section 307C of the Corporations Act and disclosed by directors under subsections 298(1) and 306(2) of the Act. The ASX's June 2009 and December 2009 reviews found that the preferred format continued to be for the declaration to be presented as a separate attachment to the directors' report.

#### **4.6 INTERNATIONAL DEVELOPMENTS IN AUDITOR INDEPENDENCE**

Paragraph 225(2B)(e) of the ASIC Act provides that the FRC is to monitor international developments in auditor independence, assess the adequacy of the Australian auditor independence requirements provided for in the Corporations Act and the codes of professional conduct in the light of those developments and give the Minister, and the professional accounting bodies, reports and advice on any additional measures needed to enhance the independence of Australian auditors.

The FRC undertakes this function through the monitoring and consideration of general media reports about audit independence issues, as well as material placed on the internet websites of key overseas oversight and standard setting bodies and other regulatory agencies.

One development that the FRC has been monitoring is the issuing of a consultation paper in October 2009 by the UK Auditing Practices Board (APB) about audit firms providing non-audit services to listed companies that they audit. The APB's paper sought feedback on whether there should be a prohibition on auditors providing non-audit services to the entities that they audit. The release of the APB's consultation paper followed a report in May 2009 by the House of Commons Treasury Committee which proposed a ban on the auditor providing non-audit services.

In July 2010, immediately after the end of the period covered by this report, the APB announced the results of the stakeholder feedback on this issue: the overwhelming view of respondents (irrespective of the constituency involved) is that there should be no outright prohibition on the provision of non-audit services. The APB observed, however, that there was stakeholder agreement that auditor objectivity and independence is perceived to be adversely affected by the provision of non-audit

## Monitoring auditor independence

services and that improved transparency and governance would address these concerns.

The FRC will continue to monitor the UK developments to determine whether there are any ramifications for Australia's auditor independence requirements.



## **5 GOVERNANCE AND ADMINISTRATION**

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### **5.1 ESTABLISHMENT, FUNCTIONS AND POWERS**

The Financial Reporting Council is a statutory body under the ASIC Act. The FRC is responsible for providing broad oversight of the process for setting both accounting and auditing standards, as well as monitoring the effectiveness of auditor independence requirements in Australia and giving the Minister reports and advice on these matters. A summary of the FRC's statutory functions appears in Appendix C.

The FRC operates within a framework set out in Part 12 of the ASIC Act. The Act sets out core objectives for accounting and auditing standards setting in Australia:

- Accounting standards should facilitate the Australian economy by reducing the cost of capital and enabling Australian entities to compete effectively overseas, and should maintain investor confidence in the Australian economy, including its capital markets.
- Accounting and auditing standards should facilitate the Australian economy by being clearly stated and easy to understand.

The ASIC Act expressly limits the FRC's ability to become involved in the technical deliberations of the AASB and AUASB. In particular, it provides that the FRC does not have power to direct the AASB or AUASB in relation to the development, or making, of a particular standard, or to veto a standard formulated or recommended by the AASB or AUASB. This provision is designed to ensure the independence of the standard setters.

### **5.2 MEMBERSHIP AND MEETINGS**

Under section 235A of the ASIC Act, the members of the FRC are appointed by the Minister on a part-time basis and hold office on terms and conditions determined by the Minister. Most members of the FRC have been appointed on the basis of nominations put forward by key stakeholder groups.

As at 30 June 2010, the FRC had 19 members. During 2009-10, two members retired while two new members were appointed. A full list of members during 2009-10, and the stakeholders who nominated them, is in Appendix A.

Five meetings of the FRC (including one workshop) were held during 2009-10.

### **5.3 CONSULTANTS**

During 2009-10, no consultants were engaged to perform work on behalf of the FRC.

### **5.4 COMMUNICATION AND CONSULTATION**

The FRC uses its internet website ([www.frc.gov.au](http://www.frc.gov.au)) and meetings with stakeholders and other interest groups as its primary means of communication and consultation.

The FRC regularly issues bulletins that communicate decisions taken at its meetings and other important developments in accounting and auditing standard setting. These bulletins are available on the FRC website. Other material available on the website includes information about the FRC's members, minutes of past FRC meetings, reports published by the FRC and its procedural rules.

### **5.5 FINANCES**

In 2009-10, the Australian Government provided funding of \$2,429,000 through the Treasury for the purposes of the FRC. Expenditure by the FRC out of this appropriation included:

- \$1,000,000 of IASC Foundation contributions in 2010;
- \$676,490 in salaries and superannuation (including for the FRC Chairman);
- \$31,241 in sitting fees for FRC members (other than the Chairman), including sitting fees for attendance at committee meetings;
- \$152,898 on travel; and
- \$39,953 on overheads.

Particulars of the funding for the AASB and AUASB (including the sources of that funding) are included in the separate reports of the AASB and AUASB.

## **5.6 FREEDOM OF INFORMATION**

The FRC Secretariat, on behalf of the FRC, maintains possession of the following documents:

- FRC meeting agenda papers;
- administrative and technical papers concerning the FRC's functions and its performance in regard to those functions;
- copies of minutes and bulletins issued by the FRC; and
- correspondence between the FRC, stakeholder groups and members of the public.

Requests under the *Freedom of Information Act 1982* for access to documents in the possession of the FRC can be directed to the FRC Secretariat at the contact details shown on page 10.

The FRC did not receive any applications for access to documents under the *Freedom of Information Act 1982* during 2009-10.

## **5.7 REGULATORY IMPACT STATEMENTS**

The FRC did not submit any regulatory impact statements in 2009-10.



## **APPENDICES**

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## APPENDIX A

### MEMBERS OF THE FINANCIAL REPORTING COUNCIL 1 JULY 2009 TO 30 JUNE 2010

#### Chairman

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

#### Deputy Chairman

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

#### Members

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

Kathryn Campbell      Deputy Secretary, Financial Management Group, Department of Finance and  
Deregulation, Canberra  
Nominated by the Australian Government  
Appointed from 22 September 2006 to 31 October 2009; reappointed from  
5 November 2009 to 4 February 2010

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

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

**Members (continued)**

Michael Dwyer	Member, Australian Securities and Investments Commission, Melbourne Nominated by the Australian Securities and Investments Commission Appointed from 3 June 2009 to 11 December 2011
John Gethin Jones	Consultant, Brisbane Nominated by the Investment and Financial Services Association Appointed from 11 June 2006 to 10 June 2009; reappointed from 11 June 2009 to 10 June 2012
Stein Helgeby	General Manager, Financial Management Group, Department of Finance and Deregulation, Canberra Nominated by the Australian Government Appointed from 24 February 2010 to 23 February 2013
Noelle Kelleher	Partner, Deloitte Touche Tohmatsu, Melbourne Nominated by the Association of Superannuation Funds of Australia Appointed from 3 June 2009 to 2 June 2012
Merran Kelsall	Chairman, Auditing and Assurance Standards Board, Melbourne Nominated by the Australian Government Appointed from 29 July 2008 to 9 August 2010
Eric Mayne	Chief Supervision Officer, Australian Securities Exchange, Sydney Nominated by the Australian Securities Exchange Appointed from 6 March 2006 to 26 February 2009; reappointed from 6 April 2009 to 5 July 2009, with an extension on 3 June 2009 to 2 June 2012
Jim Murphy	Executive Director, Markets Group, Australian Treasury, Canberra Nominated by the Australian Government Appointed from 7 March 2003 to 6 March 2006; reappointed from 7 March 2006 to 6 March 2009 and 6 April 2009 to 5 July 2009, with an extension on 3 June 2009 to 2 June 2012
Kevin Simpkins	Chair, Accounting Standards Review Board of New Zealand, Wellington Nominated by the New Zealand Minister of Commerce Appointed from 3 June 2009 to 28 February 2014
John Stanhope	Chief Financial Officer and Group Managing Director, Finance and Administration, Telstra Corporation Limited, Melbourne Nominated by the Group of 100 Inc Appointed from 6 March 2006 to 26 February 2009; reappointed from 6 April 2009 to 5 July 2009, with an extension on 3 June 2009 to 2 June 2012
Kevin Stevenson	Chairman, Australian Accounting Standards Board Nominated by the Australian Government Appointed from 1 July 2009 to 30 June 2014

**Members (continued)**

John Trowbridge	Member, Australian Prudential Regulation Authority, Sydney Nominated by the Australian Prudential Regulation Authority Appointed from 29 July 2008 to 30 June 2009; reappointed from 15 September 2009 to 14 December 2009 and 15 December 2009 to 30 June 2010
Jan West AM	Partner, Deloitte Touche Tohmatsu, Melbourne Nominated by The Institute of Chartered Accountants in Australia Appointed from 7 March 2005 to 6 March 2008; reappointed from 29 July 2008 to 28 July 2011
Stuart Wilson	Chief Executive, Australian Shareholders' Association Nominated by the Australian Shareholders' Association Appointed from 29 July 2008 to 28 July 2011
Klaus Zimmermann	Chief Executive Officer, Eldercare Incorporated, Adelaide Nominated by the National Institute of Accountants Appointed from 7 March 2003 to 6 March 2006; reappointed from 7 March 2006 to 6 March 2009 and 6 April 2009 to 5 July 2009, with an extension on 3 June 2009 to 2 June 2012



## APPENDIX B

### ATTENDANCE AT MEETINGS

#### FINANCIAL REPORTING COUNCIL

The FRC held four regular meetings and one workshop during 2009-10. Members' attendance is shown in the table:

Members	Number of meetings		
	Eligible to attend	Attended	Apologies
J Lucy AM (Chair)	5	5	0
B Brook	5	4	1
K Campbell	3	2	1
D Challen	5	4	1
M Coleman	4	4(a)	0
M Coughlin	4	4(a)	0
M Dwyer	5	5	0
J Gethin Jones	5	5	0
S Helgeby	2	2	0
N Kelleher	5	4	1
M Kelsall	5	5	0
E Mayne	5	4	1
J Murphy	5	4	1
K Simpkins	5	5	0
J Stanhope	5	5	0
K Stevenson	5	5	0
J Trowbridge	4	4	0
J West AM	5	4	1(b)
S Wilson	5	5	0
K Zimmermann	5	5	0

(a) Prior to their reappointment to the FRC on 14 December 2009, Messrs Coleman and Coughlin each attended one meeting as an observer.

(b) Ms West was represented at one meeting by Mr Lee White, of The Institute of Chartered Accountants in Australia.

## **FRC NOMINATIONS COMMITTEE**

The FRC Nominations Committee held two formal meetings in 2009-10. Members' attendance is shown in the table below:

<b>Members</b>	<b>Number of meetings</b>		
	<b>Eligible to attend</b>	<b>Attended</b>	<b>Apologies</b>
K Zimmermann (Chairman)	2	2	0
K Campbell	1	1	0
D Challen	2	2	0
M Coughlin	2	1	1
M Kelsall	2	1	1
J Lucy AM	2	0	2
E Mayne	2	1	1
K Stevenson	2	2	0
J West AM	2	2	0

Prior to 18 May 2010, the Chairmen of the AASB and AUASB were ex-officio members of the Committee for consideration of matters relating to their respective Boards. On 18 May, the FRC agreed to appoint the Chairmen of the Boards as full members of the Committee.

## **AUDIT INDEPENDENCE COMMITTEE**

The Audit Independence Committee did not hold any formal meetings during 2009-10. During this period, the FRC's work on auditor independence was dealt with by the full Council.

## **APPENDIX C**

### **SUMMARY OF THE FRC'S FUNCTIONS**

#### **FRC'S FUNCTIONS**

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

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

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

#### **SPECIFIC ACCOUNTING AND AUDITING STANDARDS FUNCTIONS**

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

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

- giving the Offices of the AASB and AUASB advice or feedback on their budgets and staffing arrangements (including level, structure and composition of staffing) (paragraphs 225(2)(ba) and (2A)(ba));
- determining the AASB's and AUASB's broad strategic directions (paragraphs 225(2)(c) and (2A)(c));
- monitoring the development of international accounting and auditing standards and the accounting and auditing standards that apply in major international financial centres (paragraphs 225(2)(e) and (2A)(e));
- furthering the development of single sets of accounting and auditing standards for world-wide use with appropriate regard to international developments (paragraphs 225(2)(f) and (2A)(f));
- promoting the continued adoption of international best practice in the Australian accounting and auditing standard setting processes if doing so would be in the best interests of both the private and public sectors in the Australian economy (paragraphs 225(2)(g) and (2A)(g)); and
- monitoring: the operation of accounting and auditing standards to assess their continued relevance and their effectiveness in achieving their objectives in respect of both the private and public sectors of the Australian economy; and the effectiveness of the consultative arrangements used by the AASB and AUASB (paragraphs 225(2)(h) and (2A)(h)).

## **SPECIFIC AUDITOR INDEPENDENCE FUNCTIONS**

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

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

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

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



## APPENDIX D

### AUDIT-RELATED DISCLOSURE REQUIREMENTS

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

- paragraph 298(1AA)(c) of the Corporations Act, which requires a company (other than a company limited by guarantee), registered managed investment scheme or disclosing entity to include in its directors' report for each financial year a copy of the auditor's independence declaration under section 307C in relation to the audit for the financial year;
- paragraph 298(1AB)(b) of the Corporations Act, which requires a company limited by guarantee to include in its directors' report for each financial year a copy of the auditor's independence declaration under section 307C in relation to the audit or review for the financial year;
- section 300 of the Corporations Act, which requires the following information to be included in the directors' report of a listed company:
  - if a registered company auditor plays a significant role in the audit of a listed company for a financial year in reliance on a declaration made under section 342A<sup>11</sup>, 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

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<sup>11</sup> Section 342A of the Corporations Act outlines the circumstances, and manner, in which ASIC may modify the auditor rotation requirements contained in section 342DA of the Act.

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

: a statement of the directors' reasons for being satisfied that the provision of those non-audit services during the year by the auditor (or by another person or firm on the auditor's behalf) did not compromise the auditor independence requirements of the Corporations Act;

- subsection 306(2) of the Corporations Act, which provides that the directors' report of a disclosing entity must include a copy of the auditor's independence declaration under section 307C in relation to the audit or review of the half year; and
- paragraphs Aus 126.1 and Aus 126.2 of accounting standard AASB 101 *Presentation of Financial Statements*, which require an entity or economic entity to disclose in its financial report the remuneration of:
  - the auditor, showing separately amounts for audit and non-audit services (including, in the case of the latter, the nature and amount of each of the non-audit services provided by the auditor); and
  - a practice related to the auditor's firm for non-audit services provided in relation to the entity or economic entity (including the nature and amount of each category of non-audit service).

## ABBREVIATIONS

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The following abbreviations are used throughout this report:

AASB	Australian Accounting Standards Board
AOSSG	Asian-Oceanian Standards Setters Group
APES	Accounting Professional and Ethical Standard
APESB	Accounting Professional and Ethical Standards Board
ASA	Australian Auditing Standard
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
ASQC	Australian Quality Control Standard
ASRB	Accounting Standards Review Board (of New Zealand)
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
AUASB	Auditing and Assurance Standards Board
CALDB	Companies Auditors and Liquidators Disciplinary Board
Corporations Act	<i>Corporations Act 2001</i>
CPP	Certificate of Public Practice
FASB	Financial Accounting Standards Board (of the United States)
FRC	Financial Reporting Council
FRSB	Financial Reporting Standards Board (of New Zealand)
FSB	Financial Stability Board

## Abbreviations (continued)

GAAP	Generally Accepted Accounting Principles
GFS	Government Finance Statistics
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IASC Foundation	International Accounting Standards Committee Foundation
ICAA	The Institute of Chartered Accountants in Australia
IFRS	International Financial Reporting Standards
ISA	International Standard on Auditing
MOU	Memorandum of Understanding
NIA	National Institute of Accountants
PCAOB	Public Company Accounting Oversight Board (United States)
PPC	Public Practice Certificate
QA	Quality assurance
RCA	Registered company auditor
SEM	Single Economic Market
SMEs	Small and medium-sized entities
SMSF	Self-Managed Superannuation Fund
TTAASAG	Trans-Tasman Accounting and Auditing Standards Advisory Group
Treasury	Australian Treasury
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.

