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**Grant Thornton Australia
Limited**

Committee Secretary
Parliamentary Joint Committee on
Corporations and Financial Services
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Canberra ACT 2600

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Inquiry into Regulation of Auditing in Australia

Dear Secretary,

Thank you for the opportunity to participate in the Inquiry into Regulation of Auditing in Australia via this written submission.

Grant Thornton Australia Limited "Grant Thornton" supports any debate and steps to improve the financial reporting and audit industry in Australia. It is critical that we attract talent in the industry that supports innovation and quality. Whilst we believe there needs to be increased awareness and improvements, we are cognisant that any action could have wider consequences across other markets for which they are unintended. Internationally, a number of markets are grappling with the same matters we are experiencing in Australia – it would be best practice to critically assess options being considered in other jurisdictions.

We strongly believe that the financial statement audit needs to be updated and refreshed to provide better value and assurance to a wider group of stakeholders, all of whom have a financial interest in the success or failure of the organisation being audited (including employees, suppliers, customers, investors and local communities). This should include:

- Clarifying who the audit is intended for, what assurances are required and then ensuring that subsequent reforms are stakeholder driven;
- Ensuring that all parties (including financial statement preparers, those charged with governance and auditors) play their role in supporting improved quality of reporting, governance and ownership;
- Being bold with suggested reforms to broaden audit scope concerning fraud, viability and non-financial reporting;
- Thinking creatively about ways to address the binary nature of audit reporting and deal with the complexities of modern accounting; and
- Opening the audit profession to the full possibilities of technological advancement.

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Framework for change

Grant Thornton is the fifth largest audit firm in Australia and belongs to a co-ordinated international network. We offer a range of services, primarily to mid-market growing entities. We are well placed to represent this segment of the market in this debate.

Grant Thornton recommends that any changes need to consider the size and complexity of the market such that further compliance is not imposed on a segment of the market where the benefit would be debatable. This could be done by applying a two-tiered approach to the listed market defined by public interest, size and complexity. Any proposed change should seek to increase the value and experience of stakeholders, people within the industry and quality and relevance of the audit process.

We are concerned that any changes in legislation will be focussed on driving changes in the listed environment, and typically the very large listed market. We urge the Committee to remain alert to potential 'scope creep' that may impact privately held businesses and restrict their access to high quality professional advice.

Our response deals with our observations and recommendations in the following broad themes:

- Perception and relevance of audit and financial reporting
- Competition and pricing
- Conflict
- Quality
- Regulation

Should you have any queries related to our submission, please feel free to contact us.

Yours sincerely

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Response to the inquiry into regulation of auditing in Australia

In this section, Grant Thornton Australia offers its response to the inquiry of the regulation of auditing in Australia.

1. Perception and relevance of audit and financial reporting

The Auditing and Assurance Standards Board (AUASB) has conducted several surveys on audit quality perceptions by Audit Committee Chairs and Investors. Many investors feel that the quality of financial reporting disclosures and audit quality was sufficient. However, we maintain that audit quality is best achieved in an environment where there is support from, and appropriate interactions among, participants in the financial reporting supply chain.

Talent for the future

The audit industry in Australia struggles in attracting and retaining talent that can gain sufficient experience to become Registered Company Auditors. Factors that may contribute to this issue are the short timeframe for reporting of listed companies, the nature of the regulatory environment, the trend towards litigation (including class actions), and limited use of technological development in international auditing standards. Grant Thornton would support a program to assess the impact on human capital and the factors required to attract, develop and retain the strongest talent for future innovation and increases in quality.

The framework

International Financial Reporting Standards have grown in complexity due the advancement of complex financial instruments, impairments and stakeholder requirements. Similarly, Auditing Standards have also grown in complexity, with a large focus on estimation and judgements. The benchmark used to assess the quality of audit evidence has also significantly shifted over time. The Australian Securities and Investments Commission (ASIC) audit inspection findings largely focus on the judgements and estimates around revenue recognition, impairments and fair value assessments.

Grant Thornton believes there needs to be a long-term assessment to increase financial reporting clarity based on user requirements. In addition, we would promote improved proportionality of reporting, auditing and assurance requirements for the varying segments of the market. As the standards look to the future, we would encourage the Australian Accounting Standards Board (AASB) and the AUASB to focus on the use of whole-population analytics, bridging the expectation gap on fraud and expanding the going concern assessment.

Education

Grant Thornton would welcome a discussion and improved education on the expectation gap on the role of the auditor and the responsibilities of company directors. The debate is necessary to assess the user requirements for information for various layers of public interest entities as well as the relevant assurances that may be offered. We believe this will enhance the understanding of what is required from the company as well as assessment of auditor quality. We often find auditors being assessed on the wrong factors to determine their quality and independence. The development of a Quality Metric, based on root cause analysis, would assist in this discussion.

Focus on the control environment

Grant Thornton supports measures to reinforce the role of directors and other stakeholders in the maintenance of an appropriate control environment and the preparation of high-quality financial statements. We see the role of audit as part of a wider ecosystem where other stakeholders also have responsibilities. We note that quality has improved in the United States market with the introduction of greater responsibility and promotion of the role of directors in respect of their duties and the requirements of the auditor to report on the control environment.

We consider that risk management and internal controls underpin all businesses. As such, we support that directors should be required to make a more explicit statement regarding these areas and enhanced disclosures on reporting of risks affecting the business. We agree that an entity's internal control assessment should be subject to audit. The Australian listed market is highly segmented, with a large disparity between ASX 300, the remaining listed population and the unlisted market. We would be supportive of internal control reporting and sign off within the ASX 300 population.

2. Competition and pricing

Market concentration

The Big 4 audit firms audit over 90% of the largest and most complex of Australia's listed entities by market capitalisation. The remainder of the listed market is highly segmented, with the Big 4 auditing approximately 68% of the next 300 largest clients and 32% of the medium client segment¹. Recommendations that reference the findings of the Bryden report in the United Kingdom should be considered in the light of this different market structure.

With group reporting requirements this dominance by the Big 4 extends to subsidiaries of the listed companies without any consideration for the preference, size and complexity of the subsidiary/local business.

Rotation

With the recent introduction of revised independence and rotation rules, partners may undertake an audit for five years in the capacity of lead engagement partner and then rotate off for a period of no less than five years (once the transitional arrangements have ceased). In the spirit of this, we would support amendments to the ASX Corporate Governance Disclosure requirements in relation to an explicit statement by Those Charged with Governance in cases where they have retained the same audit firm for 10 or more years in order to provide transparency on the perception of audit firm rotation.

Pricing

Audit and Assurance in Grant Thornton is not a loss leader. We do acknowledge, as is highlighted in the AUASB *Audit Market Structure and Competition in Australia* research paper that current market pricing does not accurately reflect the risk attributed to the service and, on average, audit prices have remained static whilst listed companies which are being audited have both grown in size and complexity.

3. Conflict

Chartered Accountants Australia and New Zealand (CA ANZ), the Association of Chartered Certified Accountants (ACCA) and International Federation of Accountants (IFAC) recently released a thought leadership paper on the multidisciplinary firm and why this supports audit quality. The evidence shows that a multidisciplinary approach, drawing on deep methodology and frameworks for assurance, combined with specialist and subject matter expertise, is well positioned to meet this need and will be increasingly vital as the market continues to evolve towards integrated thinking. We concur with the report that a multi-disciplinary approach to complex audits is necessary to enhance audit quality.

A common proposal is the prohibition of non-audit services to listed companies. In recent years, this has seen significant change in the international arena with changes in the Public Company Accounting and Oversight Board (PCAOB) independence rules, European Union audit reform and the International Ethics Standards Board for Accountants (IESBA) Code of Ethics. We support consideration in the Australian market of areas where non-audit services are incompatible with the position of the

¹ [AUASB Research Report 3, Audit Market Structure and Competition in Australia.](#)

independent auditor. We believe pre-approval of non-audit services by a company's audit committee in line with Corporations Act and Code of Ethics would further enhance the perception of independence.

However, we do not consider that banning non-audit services would necessarily address competition concerns, as more firms could potentially be conflicted from the audit appointment. We caution that any reforms need to align with the international approach lest they create undue standalone complexity and compliance obligations in contrast to international jurisdictions.

We would also recommend strengthening the rules over previous audit partners being involved in audit clients, such as board appointments, to clarify and support the perception of independence.

Grant Thornton would also recommend enhancing the Corporations Act disclosure requirements on non-assurance services and assurance services, and greater education in the market on these definitions.

We also note that care needs to be taken to make sure that further restrictions do not have unintended consequences for smaller listed or unlisted mid-market businesses. These businesses often have more limited resources and use one firm for audit and non-audit services. Further restrictions aimed at this segment could act as an impediment to growth for the mid-market by reducing access to appropriate professional advice.

4. Quality

Grant Thornton has a strategy and focus to improve audit quality. The significance of raising audit quality has been acknowledged externally by regulators, investors, capital markets and clients.

Grant Thornton supports the development of Quality Indicators, which evaluate the root cause of audit findings and reflect continued investments in improving audit quality. We agree that these indicators should be developed and reported on by ASIC. We would encourage amendments be made to the Corporations Act requirement for audit transparency reports to reflect these audit quality indicators.

5. Regulation

The audit profession in Australia is robustly regulated with a number of inspections from various market regulators, CA ANZ and our own internal inspection policy within Australia and Internationally. Grant Thornton supports the continuous ASIC inspection process. We support equal regulatory treatment of all audit firms in the listed company space. The largest six audit firms are currently inspected on a continuous basis by ASIC, with the regulatory reports released publicly to the market on a 12 month cycle moving forward.

We would also support the ability for audit firms to resign from listed company audits without the formality of submitting a request for ASIC consent. Under the Corporations Act, ASIC is required to consent to listed companies' change of auditor, even in cases where clients may fail professional standard requirements on re-acceptance.

The Australian market is also one of the few in the world where all companies are required to lodge their financial statements with ASIC within a four month period. This has a direct impact on attracting talent within the market and also on the condensing of the year-end financial audit period to four months. Providing incentives to companies to change year ends and staggering the lodgement dates by assessing public interest, size and complexity, would ensure the continual focus on quality audits. Deadlines for audits should be considered in light of the overall discussion on the future of audit.