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Parliamentary Joint Committee on Corporations and Financial Services  
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Dear Chair and Members of the Joint House Committee on Corporations and Financial Services

## **Re: Regulation of Auditing in Australia**

### **Audit Firm Rotation**

## **Recommendations**

Mandatory audit firm rotation be introduced for all publicly listed companies holding a banking licence under the *Banking Act 1959* (Cth) with a rotation of audit firms required every 10 years.

Prohibitions should also apply to non-audit related services that can be provided by the incumbent audit firm so as to prevent conflicts of interests and to maintain auditor independence.

## Introduction

This submission to the inquiry into the **Regulation of Auditing in Australia** relates to the subject of audit firm rotation as opposed to audit partner rotation.

Given the findings of the Hayne Royal Commission and with remediation provisions announced to date of some \$10 billion dollars it must be now clear to the Australian public and politicians that the major audit firms engaged by Australia's major banks have been "*asleep on the job*" when signing off on their annual audit reports.

An issue that this committee must review is the conflict of interests involved when financial service firms seek "*independent reports*" from firms that are paid large retainers for other professional service, an issue raised by the Hayne royal commission over Clayton Utz's "*independent report*" to AMP and regarding multiple "*independent reports*" produced by EY for insurer Allianz.

The current requirements for audit partner rotation for listed and APRA regulated entities are provided in **Exhibit #1**.

The audit firms and incumbent audit partners of the Major Banks and second-tier banks are as follows:

### Audit Firms of the Major Banks

Commonwealth Bank of Australia – **PwC**  
National Australia Bank – **EY**  
Westpac – **PWC**  
ANZ – **KPMG**

### Audit Firms of Second Tier Banks

AMP Bank – **EY**  
Macquarie Bank – **PwC**  
Bank of Queensland – **KPMG**  
Bendigo and Adelaide Bank – **EY**  
ME Bank – **Deloitte**

## ASIC Inspection Program

ASIC has had a long-running audit inspection program and the Committee should seek information from ASIC on the outcomes of this inspection program which to date has been kept confidential by ASIC.

## Audit Failures in Australia

Apart from the findings of the Hayne Royal Commission, the following is a summary of recent audit failures in Australia



- v Dick Smith
- v Hastie
- v Ashley Services



- v LM First Mortgage Income Fund
- v Penrice Soda Holdings
- v Qinitis



- v Discovery Metals
- v Equititrust
- v Allco
- v Premium Income Fund
- v GDI Investment Management



- v Vocation
- v Centra
- v Provident Capital

## European Audit Reforms

Public interest entities (PIEs) in the United Kingdom are now subject to **Audit Firm Rotation** every 10 years.

In April 2014 the European Union published its:

- Revised Audit Directive and
- Audit Regulations

## REGULATION OF AUDITING IN AUSTRALIA 2ND SUBMISSION

- Mandatory audit firm rotation is introduced (Regulation, Articles 16 and 17, hardwired into UK law in [the Statutory Audit and third Country Auditors Regulations part 3](#) (amending the Companies Act 2006, s490 et seq)), such that PIEs have to appoint a new firm of auditors every 10 years. The UK has taken up a member state option to extend this maximum period to 20 years provided the audit is subject to a public tendering carried out at least every 10 years.
- Tendering at least every 10 years is required for all PIEs. This compares with (in the UK)
  - [current FRC requirements](#) (UK Corporate Governance Code, C3.7 for FTSE 350 companies to retender or explain why not every 10 years, and
  - a prospective [Competition and Markets Authority requirement](#) for FTSE350 to retender every 10 years with no 'explain' option.
- The Regulation permits the 'competent authority' (in the UK, the FRC), on request, to grant an extension of up to 2 years. The FRC has published [guidance](#) on how to apply for such an extension.

**Furthermore there are prohibitions on non-audit services being provided by the incumbent audit firm so as to avoid conflicts of interests and maintain auditor independence.**

- The Regulation (Article 5, as amended by the 11 June correction) includes a new list of prohibited activities for PIE audits. This, as slightly amended by the FRC, is repeated in the [ES at 5.167R](#). In general terms, this covers broadly similar types of activities to those covered in current independence requirements but have a wider scope and fewer exceptions. For example:
  - Tax – current requirements prohibit various types of tax service: the new ones cover substantially all tax work unless it has no material effect on the financial statements being audited;
  - There is a virtually complete prohibition on several other activities where there are currently a number of caveats and exceptions, including internal audit and corporate finance;
  - The prohibition on being involved in management activities now specifically includes (according to a Recital to the Regulation) working capital and cash management and providing financial information;
  - The current exception for immaterial items is now restricted only to tax and valuation services;
  - The provision of design and implementation of internal control over financial information and systems is now prohibited in the 12 months before appointment as auditors, as well as during the period of appointment.

<https://www.icaew.com/technical/ethics/auditor-independence/implementation-of-european-audit-reforms>

## Recommendations

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Prohibitions should also apply to non-audit related services that can be provided by the incumbent audit firm so as to prevent conflicts of interests and to maintain auditor independence.

# Appendix A

## Terms of Reference

The following matters were referred to the Parliamentary Joint Committee on Corporations and Financial Services for inquiry and report by 1 March 2020:

Regulation of auditing in Australia with particular reference to:

1. the relationship between auditing and consulting services and potential conflicts of interests;
2. other potential conflicts of interests;
3. the level and effectiveness of competition in audit and related consulting services;
4. audit quality, including valuations of intangible assets;
5. matters arising from Australian and international reviews of auditing;
6. changes in the role of audit and the scope of audit products;
7. the role and effectiveness of audit in detecting and reporting fraud and misconduct;
8. the effectiveness and appropriateness of legislation, regulation and licensing;
9. the extent of regulatory relief provided by the Australian Securities and Investments Commission through instruments and waivers;
10. the adequacy and performance of regulatory, standards, disciplinary and other bodies;
11. the effectiveness of enforcement by regulators; and
12. any related matter.

# Exhibit #1

Accounting Professional & Ethical Standards Board

**Table 1: Rotation requirements for Listed Entities and APRA regulated entities**

| Role                     | Current             |                         | Transition<br>(1 Jan 2019<br>to pre<br>31 Dec 2023) |                         | Full<br>Provisions<br>(post 31 Dec<br>2023) |                         |
|--------------------------|---------------------|-------------------------|---|-------------------------|---|-------------------------|
|                          | Time<br>on<br>(yrs) | Cooling<br>off<br>(yrs) | Time<br>on<br>(yrs)                                 | Cooling<br>off<br>(yrs) | Time<br>on<br>(yrs)                         | Cooling<br>off<br>(yrs) |
| Engagement Partner       | 5/7**               | 2                       | 5/7**   | 3                       | 5/7**                                       | 5                       |
| EQCR Partner             | 5/7**               | 2                       | 5/7**   | 3                       | 5/7**                                       | 3                       |
| Other Key Audit Partners | 7                   | 2                       | 7   | 2                       | 7   | 2                       |

**\*\*** In accordance with applicable laws and regulations, Audit Engagement and EQCR Partners can serve in the same role for a maximum of five years<sup>1</sup>, but may be extended by the Audit Client or a regulator in accordance with applicable laws and regulations.<sup>2</sup>

Pursuant to paragraph 290.168, firms may have the opportunity for relief from the partner rotation requirements in the Code based on an exemption provided by a relevant regulator, subject to conditions being imposed.<sup>3</sup> Where such relief is available, the individual could remain as a Key Audit Partner (for example, as the Engagement Partner) on the audit engagement in accordance with any conditions specified under such relief.