



23 October 2019

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

Our reference: EXT2019/99

Submission to the Regulation of Auditing in Australia

The Australian Charities and Not-for-profits Commission (**ACNC**) welcomes the opportunity to provide a submission to the Parliamentary Joint Committee on Corporations and Financial Services for the inquiry into regulation of auditing.

The ACNC was established on 3 December 2012 by the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (**ACNC Act**). The objects of the ACNC Act are to:

- a. maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector; and
- b. support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and
- c. promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector

The ACNC maintains a free and searchable online public register of charities (**the Charity Register**). The Charity Register helps the public to understand the work of the charity sector and enables charities to be transparent by publishing information about their governance, activities, operations, and finances.

The ACNC regulates over 57,000¹ charities in Australia which are a sub-sector of the NFP sector. It is with regard to the charities sub-sector and the below Terms of References (**TOR**) that we frame our response:

TOR 1: the relationship between auditing and consulting services and potential conflicts of interests;

TOR 4: audit quality, including valuations of intangible assets;

TOR 5: matters arising from Australian and international reviews of auditing;

TOR 8: the effectiveness and appropriateness of legislation, regulation and licensing;

TOR 11: the effectiveness of enforcement by regulators

¹ See <http://www.acnc.gov.au> for the most up to date figure for registered charities.



TOR 1 and 4

Audit independence under the ACNC Act

According to the Charities Report 2017², approximately 35% of registered charities are medium or large sized registered charities³. Generally, medium and large charities must submit a reviewed⁴ or audited Annual Financial Report (**AFR**) annually to the ACNC as part of their annual reporting obligations under Division 60 of the ACNC Act. The reviewers and auditors provide integrity and confidence for the Australian charity sector by providing assurance regarding whether the charity financial reports give a true and fair view and comply with the ACNC Act.

For these medium and large charities, section 60-40 of the ACNC Act requires that a signed independence declaration must be provided by a review or audit practitioner. The declaration confirms no contravention to any applicable code of professional conduct, or any contravention(s) must be fully disclosed.

The Accounting Professional and Ethical Standards Board issued the Code of Ethics for professional accountants (**the Code**), covering review and audit engagements to allow assurance service providers to act, and appear to act, with objectivity, independence, integrity, and providing the approach in managing any potential conflict of interest.

Although the Code is principles based, the ACNC is of the view that it contains the right balance of prescriptive provisions that clearly specify the key threats, and more importantly, the safeguards to address the threats. This will enable practitioners the flexibility to apply professional judgement most suitable for each scenario. It is noted that the new restructured code (effective from 1 January 2020) will further enhance the conceptual framework with explicit provisions addressing independence.

Audit quality issues

In line with the ACNC's risk-based regulatory approach, the ACNC publishes our data integrity strategy and as part of that, we conduct annual reviews of the quality of charity AFRs and publish our findings⁵. Transparency and accountability are at the heart of public trust and confidence for the charity sector.

We noted an error rate of 29.61% from our 2017 review for charities failing to disclose fees paid to each auditor or reviewer as required under the Australian Accounting Standard AASB 1054 *Australian Additional Disclosures* in their financial reports.

The standard requires the separation of audit fee and other services to be disclosed, including the nature of other services. However, an audit fee can be grouped in a single amount, that includes any additional fees incurred as a result of rectifying any audit related matters (hence not

² The 2017 Australian Charities Report is available [here](#).

³ Medium charities have annual revenue of \$250,000 or more but under \$1 million, large charities have annual revenue of \$1 million or more.

⁴ Medium charities can choose to have their financial reports reviewed or audited.

⁵ Reporting statistics for the 2017 reporting period are available [here](#).



under other services). And this disclosure standard solely applies to the assurance practitioner and its network firm, so it does not cover any other accounting practice providing other non-assurance services. The ACNC encourages the Committee to consult with the standard setters, professional accounting associations and other stakeholders regarding whether any additional disclosure (e.g. breakdown of audit fees or additional fees related to audit matters) is needed in an overall cost benefit analysis to see if the transparency and usefulness of the information outweigh the administrative burden.

In addition, our AFR reviews suggest that some practitioners, especially those in the remote and regional areas (where the number of available qualified accountants is limited) may face a higher chance of self-review threats. The threat due to the geographical location can be mitigated as per the Recommendation 25 in the ACNC's submission⁶ and Recommendation 29 in the Final Report⁷ by the independent review panel to the ACNC legislative review to give the Commissioner's discretion to permit a person who is taken to be a registered company auditor under s324 BE (1) of the Corporations Act. This effectively allows more professional accountants to undertake an audit to ease self-review threats.

More importantly, in the course of conducting our AFR reviews, we found a number of audit opinions confirming that financial reports complied with the ACNC Act and met all applicable Australian Accounting Standards where this was clearly not the case. Where some auditors do not correctly apply relevant reporting and auditing standards, we recommend that further education or monitoring should be undertaken by the professional accounting bodies to address the knowledge gap issue for small practitioners. And the most fundamental issue amongst all is whether an auditor has applied professional skepticism to adequately evaluate a charity's assessment on the applicable financial reporting framework, which ultimately determines the preparation of an AFR. With the errors that we identified, this also raises a concern about how well assurance practitioners understand and apply the ethical standards. Therefore, we strongly recommend more educational campaigns to be undertaken to promote the awareness of the Code, not just understand the contents of the ethical standards, but the spirit within.

Accordingly, to ensure any issues with the quality of an audit or the independence of an auditor are dealt with effectively, the ACNC recommends developing a referral process for regulators and other concerned parties to notify the appropriate oversight bodies.

TOR 5, 8 and 11

Inconsistent regulatory requirements on audit

The not-for-profit sector faces a myriad of legislative requirements at the Commonwealth, state and territory level⁸. As highlighted by the Australian Accounting Standards Board, financial reporting and audit requirements differ according to the regulator and the structure of an entity⁹.

⁶ ACNC submission to the review of Australian Charities and Not-for-profits Commission legislation is available [here](#).

⁷ The final report - Strengthening for Purpose: Australian Charities and Not-for-profits Commission Legislative Review 2018 is available [here](#).

⁸ ACNC research into the regulatory burden of the Australian not-for-profit sector is available [here](#).

⁹ AASB Research Report No. 5: Financial Reporting Requirements Applicable to Charities October 2017 is [here](#).



Regulators have different requirements for an audit based on revenue and assets of an entity, as well as different requirements for the qualifications of a qualified auditor.

The ACNC has made progress in reducing red tape by streamlining financial reporting requirements with some states and territories¹⁰. This allows charities to submit a single report to the ACNC which also satisfies the requirements of the state or territory regulator. However, a more effective approach would be to harmonise legislation nationally so entities would be subject to the same financial and auditing requirements in all jurisdictions.

Service performance reporting and audit

Currently, the scope of an audit or review for charities focuses primarily on the financial information. An AFR is prepared in accordance with the ACNC Act (or otherwise), where it presents a true and fair view of the financial position and performance of a charity and whether it meets all applicable Australian Accounting Standards. Although this provides material assurance about a charity's financial viability, how a charity carries out its activities in accordance with its charitable purpose and its effectiveness in doing so are not within the scope of a traditional statutory audit.

Service performance (or impact) reporting and its audit measures could bridge this gap by providing the appropriate level of flexibility for charities to best tell their story in a meaningful and auditable manner. This could further strengthen public trust and confidence by enabling charities to select and present service performance information at an appropriate level without putting undue administrative burdens on charities.

Therefore, the ACNC supports the development of a service performance reporting framework or similar in conjunction with any feasible auditing measures. It is noted that the New Zealand Accounting Standards Board of the External Reporting Board has issued service performance standards for their Tier 1 and 2 public benefit entities¹¹ effectively from 1 January 2021 for charities reporting to their regulator.

International initiative to explore auditing on less complex entities

We also note the International Auditing and Assurance Standards Board has initiated a working group to review the need for new standards or guidance for audits of less complex entities. This will be most relevant to the not-for-profit sector as auditing standards become increasingly more complex and may not necessarily suit smaller entities, especially charities and not-for-profits preparing financial statements and audits for the purpose of fulfilling their regulatory obligations. The ACNC sees opportunities for this project to be pursued and its potentials to apply to the charity sector in Australia.

¹⁰ These include South Australia, Tasmania, Australian Capital Territory, Victoria, New South Wales and Northern Territory.

¹¹ Details of the service performance standards are [here](#).



The ACNC can provide further information on any of the above, should this be useful to the Committee. Contact information for this submission is Mel Yates, Director of Reporting and Red Tape Reduction [REDACTED] or reporting@acnc.gov.au

Sincerely,

The Hon Dr Gary Johns
Commissioner
Australian Charities and Not-for-profits Commission