

Finance and Public Administration References Committee
Management and assurance of integrity by consulting services

Answers to questions on notice from 23 February 2024

Accounting Professional and Ethical Standards Board

1. QUESTION - Remuneration Disclosures (From page 24 of the Hansard)

Senator BARBARA POCOCK: Culture is a very amorphous concept, isn't it? What we actually have to talk about is behaviours—what we see day to day in the behaviour of leaders. And behaviour changes according to the penalties and inducements that are provided to it. We have a lack of penalties and we have very significant financial inducements to behave in certain ways in the opaque businesses that are the partnerships in the big four. What's your view about how we get effective oversight of such large partnerships? Would it be easier if they were smaller, as we discussed earlier today? The chair has gone through partnerships where many of them are at 20, but in many professions they are at 50. We could pull the levers on partnership size and capping, or we could think about corporate structures. Have you got views on that?

Mr Wijesinghe: I can express a personal view. Maybe, as the CPA representative said, you should look at the UK model, where there are limited liability partnerships and they have to produce financial statements as well. You could solve the disclosure, as well as the structure issue, because then it will be limited liability partnerships. That will be like a company.

Senator BARBARA POCOCK: Is it your view that a listed company is required to talk about the reveal, the remuneration, for example, and the policies around remuneration, and that they should be public in large entities like the big four?

Ms Milne: Yes, Senator. Indeed, I think that's part of our submission to the PJC. We'd hope that there would be appropriate remuneration disclosure, along the lines of the APRA-regulated bodies, which perhaps goes a bit further than ASX.

Senator BARBARA POCOCK: Can you explain?

Ms Milne: I am probably not absolutely up-to-date on it but—

CHAIR: Could you do that on notice for us?

Ms Milne: Yes, we could.

ANSWER:

APESB's [submission](#) (Number 20) to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry, included a recommendation on a method to address the issues of governance and transparency associated with partnership structures with relatively low implementation costs. The relevant extract from page 5 of the submission is replicated below:

“One such method could be changing the treatment of large firms to be similar to how Public Interest Entities (PIEs) are treated for financial reporting purposes. This change could be implemented by:

- mandating the categorisation of large firms with substantial revenue, assets and workforces as PIEs;
- requiring large firms to prepare general purpose financial reports, including the disclosure of remuneration and information relating to their operations, and subject them to audit or adopting the disclosing entities disclosure requirements of the *Corporation Act 2001* [sic]; and
- adopting remuneration and accountability practices observed in APRA-regulated listed entities.”

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ASX Corporate Governance Principles

The [Corporate Governance Principles and Recommendations \(4th Edition\)](#) set out expected corporate governance principles for ASX Listed Entities. The recommendations are not mandatory, but entities under listing Rule 4.10.3 are required to benchmark their corporate governance practices against the recommendation and disclose if they have adopted different corporate governance practices. This Listing rule also requires the listed entity to include a Corporate Governance Statement in its Annual Report or separately on the entity's website.

Principle 8 requires ASX-listed entities to remunerate fairly and responsibly. Within that principle, recommendation 8.2 states, "A listed entity should separately disclose its policies and practices regarding the remuneration of non-executive directors and the remuneration of executive directors and other senior executives."

APRA Prudential Standards

The Australian Prudential Regulation Authority (APRA) issues Standards and Practice Guides that apply to entities under its supervision (e.g., banks, insurers, and superannuation funds).

APRA Prudential Standard [CPS 511 Remuneration](#) sets out requirements for remuneration arrangements for APRA-regulated entities to ensure individuals are appropriately remunerated to prudently manage the risks they are responsible for and that consequences are in place for poor risk outcomes. It also requires the disclosure of the entity's remuneration framework and practices.

Under CPS 511, Significant Financial Institutions (SFI) are required to publicly disclose, on an annual basis, information on remuneration design, governance and qualitative information on remuneration outcomes. This includes how non-financial measures impact variable remuneration decisions, the remuneration outcomes of the Chief Executive Officer (CEO) and, on a cohort basis, the outcomes for individuals in specified roles. SFI also need to disclose deferral arrangements, outcomes and consequence management for the CEO and other specified roles.

Non-significant Financial institutions (Non-SFIs) are required to publicly disclose, on an annual basis, summary information on remuneration design, governance, and where offered, key aspects of variable remuneration. Non-SFIs would not be required to disclose any quantitative information for CPS 511.

Compared to remuneration disclosure requirements in the *Corporations Act 2001*, CPS 511 broadens the specified roles subject to remuneration oversight and provides insight into how risk and non-financial measures have been incorporated in remuneration design outcomes. Entities must still comply with the required disclosures under the *Corporations Act 2001* or the SIS Act requirements, but entities could expand on those disclosures to incorporate CPS 511 requirements.

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We note that some respondents recommended Incorporating a requirement that each partner in a large registered partnership be a Fit and Proper person and noted that this would have a similar effect to the Banking Executive Accountability Regime (BEAR), which establishes Accountable Persons for Authorized Deposit-Taking Institutions.

On the 8th of March ASIC and APRA announced the final rules and guidance on the Financial Accountability Regime (FAR) that will replace the BEAR regime.

The [media release](#) noted that:

The FAR, which replaces the Banking Executive Accountability Regime (BEAR), imposes a stronger responsibility and accountability framework for APRA-regulated entities in the banking, insurance and superannuation industries and their directors as well as their most senior executives. In doing so, the FAR aims to improve the risk and governance cultures of those financial institutions.

The FAR will come into force for the banking industry on 15 March 2024 and for the superannuation and insurance industries on 15 March 2025.

Further information on the Financial Accountability Regime is available from [this link](#) on the ASIC website.

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2. QUESTION- Successful international monitoring examples (From pages 26 - 27 of the Hansard)

Senator O'NEILL: Despite that kind of scrutiny, in 2015 Gow and Kells cite PCAOB saying:

Many of the deficiencies continue to be similar in nature to those described in previous reports.

Is this an indication from the PCAOB of an ethical failure with a governance compliance by paper?

Mr Wijesinghe: You mean failure of governance of the firms?

Senator O'NEILL: Yes, because the governance documentation seems to meet community standards. Certainly, it's the government's governance documentation that has been cited to us today by CAANZ: 'This is what we're doing. This is what we're doing. We're doing all these things. We've got these documents. We're training this way.' However, even when they have got more robust fine structures in place in the US, 2015 PCAOB reports 'continued behaviour'. Can you give me the shape of the ecosystem here in 2024 where we've had a shift to much more non-audit work, the relative value of audit and the oversight and compliance mechanisms that are currently in place in Australia and your recommendations for change?

Ms Milne: Our concern is probably more on the monitoring side rather than enforcement because you've actually got to have that middle step. You will get to some enforcement processes via complaints, but there's also everything else that needs to be the subject of continued monitoring. Each of the professional bodies has a quality-review program. We have heard in recent times from both CPA and IPA about their quality-review programs, which are dealing with the smaller end of the profession. They've invested quite a lot in terms of trying to make sure that they're fit for purpose and are useful. They're going into firms and looking at random files and issues and coming up with a report—data, which is helpful.

We are to hear from CAANZ on their quality-review program later this year, so we won't have a current view of that. It does seem to us that monitoring by virtue of some arrangements, like the quality review programs, is going to be critically important.

CHAIR: Have you seen any particular examples internationally of those that you might be able to provide to us perhaps on notice?

Senator O'NEILL: Where is monitoring working?

Ms Milne: One of the things that struck us, when we had a meeting with a representative of the FRC in the UK, was that they are doing some of that monitoring work themselves. The interesting thing—we thought this was quite a practical approach—is that they are delegating back to the professional bodies those processes for smaller firms, so that you don't get that kind of regulatory overreach with the smaller bodies. The FRC is actually doing the big firms themselves.

Senator O'NEILL: Maybe we could get a bit more information on what looked like hopeful responses to the reality of this reshaping sector. Thank you for your update on the global code of professional behaviour extending beyond the accounting profession into businesses and people doing work that's captured by no professional body.

ANSWER:

APESB encourage the Committee to consider the monitoring and enforcement models adopted by regulators in the United Kingdom and the United States of America.

The monitoring and enforcement regime needs to be designed based on the challenges facing the specific jurisdiction, taking into consideration the public interest. For example, as highlighted during this inquiry, in an Australian context, there appears to be a need for an effective monitoring and enforcement regime over consulting services, whether provided by accounting or other consulting firms.

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The Financial Reporting Council (FRC) in the UK

The FRC regulates auditors, accountants, and actuaries and sets the UK's Corporate Governance (for directors) and Stewardship Codes (for those investing money on behalf of UK savers and pensioners and those that support them)

Scope of reviews

FRC's Audit Quality Reviews (AQR) monitor the quality of the audit work of UK firms that undertake statutory audits of Public Interest Entities (PIEs), certain non-PIE entities and Major Local Audits (MLAs).

Each year, FRC announces its areas of supervisory focus for the upcoming year; see details of 'FRC's announcement for 2024/25 [here](#).

PIEs and non-PIEs entities

Firms that audit the entities that are PIEs and specific other entities (as listed below) are subject to AQR inspections (further information at [Entities included in AQR's inspection scope \(September 2022\)](#)).

Other Entities in Scope

- UK companies admitted for trading on AIM or NEX (other than the Main Board) with a market capitalisation of more than €200m, using the formula in MiFID II¹
- Lloyd's Syndicates
- Non-UK (excluding the Crown Dependencies)² entities that are not incorporated in an equivalent or transitional country, with transferable securities (equity/debt) admitted to trading on a UK-regulated market and audited by a UK Statutory Auditor.

MLAs entities

The FRC also monitors the audit quality of the largest local public bodies, which are called Major Local Audits (MLAs). These generally include larger health and local government bodies.

Part 3 of [Local Audit \(Professional Qualification and Major Local Audit\) Regulations 2014](#) defines an MLA as a body that meets the following criteria:

- Total income or expenditure of at least £500 million, or

¹ This formula is also set out under SME Listed Entity in the FRC's Glossary of Terms - Ethics and Auditing issued in December 2019.

² Excluding entities incorporated in Jersey, Guernsey, and the Isle of Man with transferable securities (equity/debt) admitted to trading on a UK regulated market which are subject to separate inspection arrangements.

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- For a local authority pension scheme, at least 20,000 members or gross assets over £1,000 million.

Delegated Agreements with professional bodies

In June 2016, the UK FRC established [Delegation Agreements](#) that empower Recognised Supervisory Bodies (RSBs), which include professional bodies such as the Association of Chartered Certified Accountants (ACCA) and the Institute of Chartered Accountants in England and Wales (ICAEW) to carry out specific regulatory tasks delegated by the UK FRC.

The FRC has delegated responsibility for the following tasks in respect of UK non-PIE audit to the RSBs:

- Registration of firms and RIs as Statutory Auditors (non-PIE)
- Audit Monitoring (non-PIE)
- Continuing Professional Development (CPD)
- Enforcement (non-PIE)

Annually, the FRC undertakes a review of the oversight work of RSBs to ensure the delegated tasks are performed to a sufficiently high standard to promote and enforce audit quality across the entire audit market. This review also forms the basis on which the FRC conclude whether the recognition of each RSB should be continued.

Frequency of reviews

PIE audit firms are grouped into 3 Tiers based on their impact on the UK audit market. FRC will review each firm's Tier status annually.

The AQR program focuses on risk-based supervision of firms carrying out audits in which the public interest is greatest. Therefore, the frequency of AQR inspections varies based on the firm's tier, as shown below.

Tier 1 firms – inspected annually

- The largest firms in the UK are BDO, Deloitte, EY, Grant Thornton, KPMG, Mazars, and PwC.

Tier 2 firms – inspected once every 3 years

- A further 5 to 7 firms, based on risk assessment. Firms with more than 10 PIE audits are likely to be in Tier 2.

Tier 3 firms – cycle of up to 6 years, including ad hoc inspections to address risks

- The remaining PIE audit firms (other than the National Audit Office (NAO) and non-UK firms) are in Tier 3.

More information on the FRC approach across the three Tiers can be found [here](#) (page 15).

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The UK FRC's three-year plan is available [here](#). Page 12 shows an expected growth in personnel from 486 to 533, predominantly in regulatory standards and supervision. The UK FRC has substantial resources.

The Public Company Accounting Oversight Board (PCAOB) in the US

The PCAOB is responsible for inspecting registered audit firms' compliance with the Sarbanes-Oxley Act, the rules of the PCAOB, the rules of the US Securities and Exchange Commission (SEC), and other regulatory and professional requirements.

Public Companies and Other Issuers

Under the *Sarbanes-Oxley Act* and [PCAOB Rule 4003](#), PCAOB will inspect:

- registered accounting firms that provide audit reports for more than 100 issuers annually; and
- those that provide audit reports for less than 100 issuers at least once every three years.

PCAOB selects the audits and audit areas that it will review. The inspected firm has no opportunity to limit or influence PCAOB's selections. PCAOB has indicated that their team will evaluate the culture across the largest domestic audit firms as part of the PCAOB staff [2024 Inspection Priorities](#).

The PCAOB inspection is designed to review a portion of a firm's issuer audits and evaluate elements of a firm's quality control system. Each firm will be provided an Inspection Report, which summarises any deficiencies identified during the inspection, such as:

- not having obtained sufficient appropriate evidence to support the audit opinion
- non-compliance with PCAOB standards or rules
- non-compliance with SEC and PCAOB rules relating to Independence; and
- criticisms or defects in the firm's system of quality control

Further information is set out in the [Guide to Reading the PCAOB's New Inspection Report](#).

If potential deficiencies are identified, the firm can review and provide a written response to the comment. The firm is also encouraged to discuss with PCAOB how it intends to address the criticisms and potential defects.

Further details are available at [PCAOB Inspection Procedures](#) and [Basics of Inspections](#).

Non-U.S. Firms

Under the *Sarbanes-Oxley Act*, PCAOB oversight also extends to non-US firms that audit or play a substantial role in the audit of US issuers and broker-dealers. These non-US registered firms are subject to PCAOB inspections in the same manner as US-registered firms.

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The PCAOB inspections have generally been carried out in two ways:

- **PCAOB-only inspections** – conducted by the PCAOB on its own in coordination with the home country regulator; or
- **Joint inspections** are conducted through formal cooperative arrangements entered into with the home country regulator.

To facilitate cross-border cooperation, the PCAOB has signed cooperative agreements with non-US regulators in other countries, including Australia.³ As of 31 December 2023, the PCAOB has conducted inspections of one or more registered firms in 57 non-US jurisdictions, including Australia.⁴ Further information: [Inspections of Non-U.S. Firms](#) and [International](#).

PCAOB administers a disciplinary regime. When violations are found, the PCAOB may impose sanctions, including censures, monetary penalties and limitations on a firm's or individual's ability to audit public companies or broker-dealers.

³ See details at [PCAOB Cooperative Arrangements with Non-U.S. Regulators](#) on PCAOB website.

⁴ See details at [Where the PCAOB has Conducted Oversight Outside the U.S. \(current as of December 31, 2023\)](#) on PCAOB website.

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High-level comparison of monitoring by audit regulators

During the 2023 year we understand that ASIC has reduced its review of audit files to 15.

Refer below to the comparison with key jurisdictions up to the end of 2022. While the US and UK are larger jurisdictions, Canada is generally considered to be a comparable jurisdiction to Australia.

Regulator	2019	2020	2021	2022
ASIC (Australia)	19 firms 58 audit files	13 firms 53 audit files	16 firms 45 audit files	14 firms 45 audit files
FRC (UK)	136 audit files	130 audit files	147 audit files	148 audit files
PCAOB (USA)	176 firms 743 audit files	153 firms 631 audit files	141 firms 690 audit files	157 firms 710 audits
CPAB (Canada)	38 firms 142 files	19 firms 119 files	24 firms 134 audit files	32 firms 132 audit files