

**Questions on notice taken at the inquiry's public hearing in Sydney on 15 March 2013. Answers received from the Australian Securities and Investments Commission.**

**Question 1**

**Mr Medcraft:** ... During our unclaimed money campaign in November, over 700,000 people visited the MoneySmart site; 4 million searches were conducted and 18,000 people found money that belonged to them. MoneySmart's professional learning program has already seen over 5,000 teachers receive professional learning. The target is 6,000 teachers by June 2013.

**Senator BOYCE:** How much money was involved in those 18,000 claims?

**Mr Medcraft:** We will take that on notice.

**Answer:**

During November 2012, a total of \$5.4 m was paid out in response to 1,205 successful claims for unclaimed money. Of these 1,205 claims, 596 indicated to ASIC that they became aware of the money through the media campaign or a search on the MoneySmart website. Many other claimants may have become aware through the media campaign or a search on the MoneySmart website, but this has not been indicated to ASIC. In part, this is because claims for money under the Banking Act and Life Insurance Act are made, in first instance, directly to the institutions, so ASIC is not able to receive such data on these claims.

In the period from November 2012 to March 2013, there were approximately 7,728 successful claims, amounting to \$26.6 million. Over 2,800 of these claimants indicated that they had become aware of the money through the media campaign or a search on the MoneySmart website.

The above reference to 18,000 people was a rounded number describing broadly how many unclaimed money search results people either printed out or emailed to themselves during the weeks of the campaign. Not all those people have made claims or when they looked closer, found that money belonged to them.

**Question 2**

**Mr FLETCHER:** So you got no further insights into where the money has gone?

**Mr Price:** I would agree with that statement, yes.

**Mr Savundra:** I think it would be fair to say, to go a bit further, that the public examination confirmed our understanding that Mr Gresham does not have any assets or funds which investors will be able to recover.

**Mr FLETCHER:** Is this within Australia?

**Mr Savundra:** This is both within and outside.

**Mr FLETCHER:** Is it your belief that he [Mr Gresham] does not have significant assets outside of Australia?

**Mr Savundra:** That was our belief before the examination and it remains our belief after the examination. We believe it has been confirmed as a result of those examinations. I anticipate, although I would need to check, that that would be the Trio liquidator's view also.

**Mr FLETCHER:** Is that true, even though the total value of commissions and other payments he would have received was in the order of several million dollars, wasn't it?

**Mr Savundra:** I would need to take that on notice, but he was asked what happened to the money, and I think it is fair to say it has been spent.

**Answer:**

The liquidators of Trio Capital Ltd (in liquidation) conducted a public examination of Paul Gresham (now known as Tony Maher) on 10 to 12 December 2012. During that examination he was questioned about the payments he received and what had happened to that money. In particular he was questioned about the approximately \$2 million he received in undisclosed commissions.

He was also questioned about assets or funds that he may have in Australia or offshore. No funds or assets of substance were identified.

Mr Gresham gave evidence that he has spent the money he received (including the undisclosed commissions) on such things as overseas travel. Mr Gresham has no remaining funds or assets of any worth.

**Question 3**

**Mr FLETCHER:** I might have a couple more questions on that in camera. I have one other question at this stage. Has ASIC provided advice to the minister in relation to the recommendations made by the committee in its report last year?

**Mr Price:** No, not to my knowledge. We certainly have had discussions with Treasury about possible responses, but I am not sure that there has been any direct interaction between us and the minister's office. Generally, our interaction is with Treasury.

**Mr FLETCHER:** You have not been asked to provide any advice in relation to any of the matters in the report?

**Mr Price:** I will take that on notice, but my recollection is no.

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**Answer**

ASIC provided the Minister's Office with a copy of an email sent to Treasury outlining ASIC's draft views on the Trio Inquiry report recommendations. This occurred shortly after the release of the Trio Inquiry report. The covering note forwarding the email also made mention to a number of the Trio Inquiry report recommendations.

**Question 4**

**CHAIR:** How do you engage whistleblowers? How seriously do you take them communicating with you? What supports are in place for people to help you identify where there are cultural issues?

**Mr Medcraft:** A big question on today, actually.

**Mr Price:** There are some specific provisions in the Corporations Act that provide protections for whistleblowers. They were introduced as part of the CLERP 9 reforms and were enacted, I think, around 2005 or 2006. There are limitations around those protections. From a policy point of view, there is a balance in promoting legitimate whistleblower behaviour on the one hand and, on the other hand, creating a legislative avenue for people who might have other incentives to try and bring in a regulator and become involved. We can provide you some further detail, and I need to take it on notice, about just how those whistleblower provisions work. But more generally, in terms of how whistleblowers interact with ASIC, I suspect that the way they would generally interact is the way that we get most reports of misconduct, and that is through our normal misconduct and breach reporting processes that we have in place at ASIC.

**Answer:*****Corporations Act 2001 (Cth) – Part 9.4AAA – Protection for whistleblowers***

Part 9.4AAA of the *Corporations Act 2001 (Corporations Act)* provides statutory protections for certain types of people as whistleblowers when they make certain types of disclosure to ASIC, a company itself, or the company's auditor, about the company's activities. These provisions were introduced in the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) and took effect on 1 July 2004.

These provisions afford statutory protections to people as whistleblowers when they are an officer or employee of the company about which they make the disclosure to parties set out below. They may also be a supplier to that company or a supplier's employee. The disclosure must indicate a contravention of the Corporations Act by the company or by an officer or employee of the company. The whistleblower should have reasonable grounds to suspect this and must make the disclosure in good faith.

The disclosure can be made to ASIC, an auditor of the company, a director, secretary or senior manager of the company, or an employee of the company who is authorised by the company to receive such disclosures. The whistleblower cannot make an anonymous disclosure. They must inform the party receiving the information of their identity before making the disclosure.

If a person meets the criteria qualifying them for protection as a whistleblower under the Corporations Act, the person will not be subject to civil or criminal liability, and cannot be subject to the enforcement of any contractual rights, arising from the disclosure they have made. Additionally, if a whistleblower is subject to victimisation for making the disclosure, the provisions entitle them to pursue a compensation action for the damages they have suffered. Also, the party to whom the disclosure is made must keep the disclosure confidential.

### **ASIC communication with potential whistleblowers**

ASIC appreciates receiving reports of misconduct from members of the public and people with connections with companies and other entities we regulate. These reports of misconduct provide us with important intelligence information about the activities and culture of the companies and other entities we regulate. Reports of misconduct also alert us to possible breaches of the Corporations Act and related laws.

ASIC keeps confidential all reports of misconduct we receive, this includes reports we receive from people who fall within the definition of a whistleblower under the Corporations Act and reports we receive from those people who do not fall within the definition.

ASIC understands the sensitivities surrounding the reports received from misconduct reporters who meet the criteria qualifying them as whistleblowers under the Corporations Act. ASIC treats reports of misconduct from potential whistleblowers seriously and given them our full and intense consideration.

ASIC has systems in place to alert us when a reporter lodging a misconduct report may meet the criteria for being considered a whistleblower set out in the Corporations Act. These systems ensure that we communicate with the people who may fall within the whistleblower definition through their private address and contact details, and obtain their consent before communicating with other parties.

ASIC has also published Information Sheet 52 *Protection for whistleblowers* setting out information on the protections available to misconduct reporters who meet the criteria set out under the Corporations Act for whistleblowers. This information sheet is available from our website.

### **Question 5**

**Senator BOYCE:** I am going to move on to debentures, but I just have one question before that. Mr Medcraft, I understand that you have set targets for gender equity and diversity within the ASIC workplace. Would you like to tell us about that, please?

**Mr Medcraft:** I will come back to you on notice, because the numbers do not come to me. Basically, overall ASIC has 56 per cent females, if my recollection is correct, and 44 per cent males. At the senior, SES, level at the end of last year, 39 per cent of our leadership was female. The target we have set at the most senior level, the SES level, is to move by 2015 to fifty-fifty. I am very pleased to say that we have a couple of senior leader roles that are now basically filled often by women who are in partnership, a joint role.

### **Answer:**

As part of a comprehensive program of work in diversity and gender equality, ASIC has established targets to increase the participation of women at the Executive and Senior Executive Service (SES) levels. ASIC has chosen to implement voluntary targets rather than mandatory quotas to ensure that the merit principle is applied in selection and promotion practices while actively working to keep these practices free from bias. The targets are:

	<b>Dec 2013</b>	<b>Dec 2014</b>	<b>Dec 2015</b>
<b>Senior Executive Service</b>	44%	47%	50%
<b>Executive Level 2</b>	47%	50%	-
<b>Executive Level 1</b>	50%	-	-

ASIC has identified a program of work which we believe will start closing the gap between male and female participation in the leadership of ASIC. It includes such activities as building awareness through unconscious bias training for SES and people managers, ensuring our core people processes and practices promote diversity and merit based recruitment and development and providing mentoring and leadership development opportunities for high potential women.

### **Question 6**

**Senator BOYCE:** Whilst I am on the topic, the Disability Discrimination Commissioner, Mr Graeme Innes, has recently suggested targets or even quotas for

the employment of people with disabilities. Again, on notice, what is ASIC's policy there?

**Mr Medcraft:** We will take it on notice. In addition to disabilities there is another one. Yesterday, ASIC and the ACCC had joint session to focus on elder issues. As we all know, there is a real issue here, particularly for those who are over 55—

**Answer:**

ASIC is committed to a diverse and inclusive workplace and recognises the value that a diverse workforce can bring to our organisation. ASIC does not presently have participation targets for people with disabilities however we have a Recruitment and Selection Policy in place to ensure our recruitment decisions are inclusive of people with disabilities.

**Question 7**

**Mr FLETCHER:** I would certainly like to provide you with a copy of it and ask you to have a look at this particular one. My follow-up question I guess would be: when you become aware of specific instances of marketing that you think raise some questions, do you fire a warning shot across the bows?

**Mr Kell:** We have done more than fire a warning shot. In fact, we have a couple of matters in court at the moment, such as Royale Capital in Queensland. I do not want to go into a lot of detail, but one aspect of that involved encouraging people, through their SMSFs, to invest not just in property here but in distressed property in the US. We have a number of enforcement matters currently underway that are looking at occasions where SMSFs have, unfortunately, been used as the vehicle for misconduct.

**Senator BOYCE:** Could you on notice provide us with a list of the cases that are in the public domain?

**Mr Kell:** Sure. I would be very happy to do that.

**Answer:**

**Investigations/litigation on foot and in the public arena**

1. **Royale Capital (QLD)** - Royale Capital Pty Ltd and ActiveSuper Pty Ltd were Queensland based companies that solicited members of the public to establish SMSFs and then recommended various share related investments to the SMSF. Civil proceedings have been commenced in the Federal Court of Australia involving 17 defendants, including several international entities. There are currently asset protection and travel restriction orders against various defendants. A provisional liquidator has been appointed to various entities, including a Queensland property development company MOGS Pty Ltd.

2. **Trio/Astarra (NSW)** - Trio Capital Ltd was a trustee and responsible entity for a number of superannuation funds and managed investment schemes. This included being the responsible entity for the Astarra Strategic Fund (**ASF**) and the ARP Growth Fund. ASF investors included both APRA regulated super funds and SMSFs. All members of the ARP Growth Fund were SMSFs. There have been a variety of administrative and criminal outcomes in this matter to date, which involves action against more than 10 individuals. These outcomes include lifetime bannings from the financial services industry and the imprisonment of the former directors of the investment manager for ASF.
3. **Wickham Securities Limited (QLD)** - Wickham (now in voluntary administration) is an unlisted unrated debenture issuer. Most of the funds it raised (approximately \$26m) came from SMSFs that had placed their funds there at the direction of a financial adviser, Mr Brad Sherwin, who through his company Sherwin Financial Planning Pty Ltd, advised his clients to establish SMSFs and invest in Wickham. Mr Sherwin also had a company DIY Superannuation Services Pty Ltd which provided administration and management services for the SMSFs. ASIC has freezing orders over the property of Mr Sherwin, his wife and several companies associated with them. The administrator estimates that the losses to investors are in the vicinity of \$58 million.

#### **Recently concluded**

4. **Supersave Superannuation Fund (NSW)** - This fund was only open to SMSFs. Many investors rolled their superannuation out of APRA-regulated funds to invest in this fund, which attracted more than 100 SMSFs and over \$7m from mid 2006 before being shut down by ASIC in late 2007. The principal behind the fund has been fined a record civil pecuniary penalty of \$500,000 for his involvement in this and related schemes.
5. **Craig Dangar (NSW)** - Charges were brought by ASIC following an investigation into Mr Dangar's conduct while he was employed to provide superannuation advice to trustees of self-managed superannuation funds, and compliance advice to accounting firms. Mr Dangar pleaded guilty to obtaining a total financial advantage of \$250,000 by recommending that two clients purchase a portion of his shares in Morris Finance Ltd, and misrepresenting the true owner of the shares.

ASIC has approximately 10 further investigations on foot which are not in the public domain and primarily concern SMSF related misconduct or other misconduct resulting in significant harm to SMSFs.

In addition to its investigations which involve significant SMSF related misconduct, ASIC will, at any time have a number of other investigations that in some manner involve SMSFs. For example, ASIC is aware that in relation to the **Westpoint**, **APCH** and **Banksia** matters, funds were raised from the public for investment from a variety of sources, including SMSFs. Given the growth in SMSF numbers, we expect that more investigations will involve some SMSF investors as a matter of course.

The matter of **Mr Mark Letten** is a further current example. Mr Letten is an accountant and was a company director of LGH Holdings Ltd (now in liquidation) who ASIC alleges operated 21 unregistered managed investment schemes involved in the acquisition and/or development of real property. The schemes collected in excess of \$110 million from approximately 1000 investors over a 10 year period. Many clients were introduced to the schemes through Mr Letten's accounting practice and many invested via their SMSF. Mr Letten has been charged with 37 offences and is waiting to stand trial in Victoria.

### **Question 8**

**Mr FLETCHER:** Of the top 300 ASX listed companies, do you have data on the rate at which they rotate the auditors now?

**Mr Price:** Not to hand. If you allow me to take that on notice I can get back to you. I seem to recall there are some academic studies at the very least. Whether they are specific to Australia I am not sure. Let me take that on notice.

**CHAIR:** It would also be good to get a view of the lay of the land—who is consulting where? Is there clustering? Could we get a mud map?

**Mr Price:** That is an area that we are currently looking at. We have a rolling audit inspection process. As part of our current auditor inspection process we are looking at the moment at the provision of non-audit services because it does change over time.

### **Answer**

The international studies referred to by Mr Price providing information on the tenures of auditors included:

- a) A study by Kate Iannelli “Mandatory Audit Firm Rotation: Explaining the Key Numbers” dated 22 March 2012 reporting that among Fortune 1000 firms, 59 percent of the firms have had the same auditor for over ten years (nearly one-fourth have had the same auditor for 21 or more years). See <http://www.directorship.com/mandatory-audit-firm-rotation-explaining-the-key-numbers> for further information; and
- b) A study by Mark Grothe & Thomas R. Weirich “Analyzing Auditor Changes: Lack of Disclosure Hinders Accountability to Investors” in the CPA Journal Online in December 2007. In the year following the disappearance of Big Five accounting firm Arthur Andersen, 22.1 percent of reporting companies changed auditors. A more normal experience was the 11.3 percent and 10.5 percent changes in 2005 and 2006, respectively. Firms with a market capitalisation of less than \$75 million change auditors at a rate of 63% whereas companies with a market capitalization of at least \$2.5 billion have an 8% turnover rate. For further information, see <http://www.nyscpa.org/cpajournal/2007/1207/infocus/p14.htm>



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We are reviewing the tenures of auditors of the top 300 ASX listed entities and will provide further information shortly.

### **Question 9**

**Mr FLETCHER:** To frame the question on notice a bit more precisely: what is the gap between the big four firms and the next in Australia, and how does that compare with other jurisdictions?

### **Answer**

Based on the latest information from Morningstar, the percentages of market capitalisation of Australian listed entities for the audit firms is as follows:

- (a) PWC: 34 per cent
- (b) Ernst & Young: 30 per cent
- (c) KPMG: 22 per cent
- (d) Deloitte Touche Tohmatsu: 7 per cent
- (e) BDO: 1 per cent
- (f) Grant Thornton: 1 per cent
- (g) Other or not stated: 5 per cent

We believe that this is a broadly similar situation in other major jurisdictions.

An IOSCO report from 2009 states:

"To illustrate the current state of concentration in the market for audit services to large issuers, in January 2008, the U.S. Government Accountability Office (GAO) concluded that, in 2006, the four largest auditing firms audited 98% of the 1,500 U.S. public companies with annual revenues over \$1 billion, and 92% of U.S. public companies with annual revenues between \$500 million and \$1 billion. Further, in 2007, the global revenues of each of the Big Four ranged between EUR 15 billion and 20 billion per year while the revenues for the next six largest audit firms following the Big Four ranged between EUR 2 billion and 3.7 billion per year."

<http://www.iasplus.com/en/binary/iosco/0909ownership.pdf>

### **Question 10**

At the last ASIC oversight hearing, ASIC stated that in terms of audit quality, you believe the Australian audit profession has got some work to do. In ASIC's view, are there any issues within the audit regulation framework that need to be looked at, or is

it more a case of certain auditors being complacent and under-performing, issues that standards or regulation could never fully eradicate?

### **Answer**

As a securities regulator, our focus is on confident and informed markets and investors. Auditors are important 'gatekeepers' in our financial system in providing independent assurance to investors and other users of financial reports. Auditors play a key role in confident and informed markets through audit quality which contributes to financial report quality.

In our view, audit quality refers to any matters that impact on the likelihood of achieving the fundamental objective of the audit which is to obtain reasonable assurance that material misstatements in the overall financial report are detected, and ensuring that any misstatements are addressed.

ASIC recognises that gatekeepers play a beneficial role in the regulatory system. Many aspects of our law rely on gatekeepers complying with their regulatory requirements. So to maintain investor confidence it's important that ASIC monitor their conduct closely. It is also important that gatekeepers such as auditors have strong quality control functions.

Ideally, gatekeepers should be self-regulating, as they should have strong incentives to maintain their professional reputation and independence, since this is an essential aspect of their services. However, gatekeepers can also contribute to market failure, particularly when their incentives are misaligned, leading to conflicts of interest and failure to act professionally and independently. This is another important reason why ASIC focuses on this area.

There are a number of contributors to audit quality. These include: firm culture; experience and expertise of auditors; firm quality control programmes; accountability of partners for audit quality; auditor independence (such as auditor rotation, fee dependence, and provision of non-audit services to audit clients); the liability regime for auditors; quality auditing standards; and independent audit firm oversight.

Our current focus is on working with the audit firms to improve audit quality, with particular focus on those audit firms that audit listed entities and having regard to the share of market capitalisation. Following the findings from our most recent cycle of audit inspections for the 18 months to 30 June 2012, we have asked the largest 6 audit firms to prepare action plans to improve audit quality with particular regard to our broad findings in relation to audit evidence, professional scepticism, and use of and reliance on experts and other auditors. This can include focusing on matters such as firm culture; experience and expertise of auditors; firm quality control programmes; and accountability of partners for audit quality. These plans are developed and owned by the firms, who will be responsible for implementing and monitoring their initiatives to improve audit quality. All of the 6 largest firms have expressed their commitment to improve audit quality.

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While recognising that audit firms have the primary responsibility for audit quality, we have also suggested improvements to the auditing standards in Australia. These standards are based on international standards. Both directly and through the International Organisation of Securities Commissions, we are pressing the international standard setters for specified changes to international auditing and ethical standards to provide better guidance to auditors.

In addition, we have made suggestions to The Institute of Chartered Accountants in Australia and CPA Australia concerning improvements to their quality review programmes for smaller firms, and improvements to their training programmes.

We are also working with audit committees and in a recent article called on audit committee chairs to ask their auditors for the findings from ASIC audit firm inspections relating to the audit of their companies. We also highlighted areas where audit committees can play an important role in relation to audit quality by ensuring that: auditors receive reasonable fees to support quality audits; auditors are fully informed of any concern and risks that may impact on the financial report and audit; and auditor independence is protected in areas, including in relation to the provision of non-audit services.

We continue to monitor the recent international proposals and developments relating to auditor independence. This includes the European Union proposals for audit reform released in November 2011, which refer to matters such as mandatory audit firm rotation and restrictions on non-audit services. In August 2011, the PCAOB issued its 'Concept Release on Auditor Independence and Audit Firm Rotation'. We continue to liaise with audit firms and other stakeholders to ensure that we fully understand the various views on these proposals.

Regulatory reform is likely to receive greater focus in Australia if: there isn't a sufficient improvement in audit quality in Australia; regulatory changes occur in the EU or US; or there is another major corporate collapse where the financial report did not adequately represent the financial circumstances of the entity and there was an audit failure.

It is in this context, we have said that there may be merits in, for example, considering mandatory audit firm rotation over an appropriate period. While recognising that there may be additional costs with mandatory firm rotation, there may also be benefits in terms of market confidence given independence and objectivity considerations, particularly if mandatory firm rotation is adopted in the EU or US. These considerations include the benefits of bringing fresh minds to the audit and addressing the fact that company management pay fees and influences the continuing appointment of an auditor. We recognise that this is a matter for Government.

### **Question 11(a)**

Mr Medcraft, at the oversight hearing last December, you stated that following ASIC's latest audit inspection report, the auditing profession should consider itself on notice. If the results in the next report do not indicate progress, what are the options for improving audit quality? Could the greater use of existing enforcement powers

address these issues, or are there legislative or regulatory changes that may need to be considered?

### **Answer**

Our views on the options to improving audit quality are outlined above in response to question 1. There are a range of matters that contribute to audit quality. If there isn't an improvement in audit quality there may be merits in considering regulatory reform.

In relation to our use of existing enforcement powers, please refer to our response to question 2b. That response includes an outline of outcomes in relation to audit matters in the last 18 months.

While noting that the maximum penalty under the Corporations Act for non-compliance with the auditing standards is only \$5,500, we recognise that any change would be reviewed in the context of all penalties under the Act and other legislation. We also have a range of other regulatory tools including the ability to refer matters to the Companies Auditors and Liquidators Disciplinary Board ("CALDB").

### **Question 11(b)**

How do the observations that there are issues with audit quality correspond with the low number of referrals of auditors by ASIC to the Companies Auditors and Liquidators Disciplinary Board? Is pursuing a matter through CALDB a viable and appropriate course of action, or is it too drastic? What other enforcement and compliance tools are available to ASIC to encourage higher quality audits?

(According to its annual reports, CALDB considered five cases relating to auditors in 2011–12, and two cases in 2010–11.)

### **Answer**

Improved conduct is achieved through a combination of regulatory tools, including education, policy, surveillance, compliance activities, enforcement action and administrative actions. The greatest impact is achieved at the least cost through our education, policy, surveillance and compliance activities. This includes our audit firm inspection programme which is designed to work cooperatively with the firms to improve audit quality.

The CALDB process is an administrative process rather than an enforcement process and is protective rather than punitive. The objective is to ensure that auditors who do not demonstrate competence in properly discharging their responsibilities as auditors do not continue to be registered or are suspended.

ASIC continues to take appropriate action against auditors. We have prepared referrals to the CALDB in a number of auditor related matters in recent years. When we present a draft Statement of Facts and Contentions ("SOFAC") to the auditor, it is

open to them to offer an enforceable undertaking. If that enforceable undertaking is acceptable and we can obtain a suitable protective outcome without the need for a CALDB referral, it makes sense to accept that enforceable undertaking.

We have made arrangements to pass draft SOFACs concerning members of The Institute of Chartered Accountants in Australia and CPA Australia to enable them to take appropriate disciplinary action against their members.

ASIC has obtained the following main outcomes in relation to auditors in the last 18 months:

<b>Auditor</b>	<b>Firm</b>	<b>Entity audited</b>	<b>Date</b>	<b>Outcome</b>	<b>Comments</b>
Stephen Cogle	PwC	Centro Properties, Centro Retail	19/11/12	Enforceable undertaking	Not practice as registered company auditor until 30 June 2015
Simon Green	Pitcher Partners Brisbane	ABC Learning Centres	6/8/12	Enforceable undertaking	Not practice as registered company auditor for 5 years
Kevin Somes	Somes & Cooke	Sandfire Resources	Ongoing (see 12/6/12 media release)	Currently before court	Auditor independence issues concerning \$3m invested in name of wife and daughter in listed entity audited by Mr Somes
Graham Abbott	-	Central West Gold NL, Morning Star Gold NL	5/4/12	Enforceable undertaking	Not to practice as a registered company auditor for a company or registered scheme under the Corporations Act
Tim Frazer	WHK Audit & Risk	Astarra Strategic Fund	6/2/12	Enforceable undertaking	Not practice as registered company auditor

	Assessment				for 3 years
Stuart Cameron	KS Black & Co	Citigold Corporation, Australian Certification Authority for Reinforcing Steel Limited, Australian Hardwood Management Limited, Adelaide Hills Investments Limited, Australian Rural Investments Limited, Microgenics Diagnostics Pty Limited	31/10/12	Enforceable undertaking	Registration as a registered company auditor cancelled
Peter Lockyer	Trood Pratt	Elderslie Finance, Grenfell Securities	19/10/11	Enforceable undertaking	Registration as a registered company auditor cancelled

### **Question 12**

In ASIC's view, what are the strengths of the framework for how auditing standards are set in Australia? What are the weaknesses, or areas that could be improved?

### **Answer**

The International Auditing and Assurance Standards Board ("IAASB") makes auditing standards internationally that are the basis for the auditing standards made by the Auditing and Assurance Standards Board.

While the primary responsibility for audit quality lies with the audit firms, and the auditing standards are relatively principles based.

Following conversations with the international and domestic standard setters in recent years, we have written directly to the IAASB outlining areas for improvements in the standards. We have asked the standard setters to focus on the three broad themes from our audit inspections, being sufficient and appropriate audit evidence, professional

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scepticism, and the use of and reliance on experts and other auditors. We have also suggested improvements to the standards in areas such as:

- (a) Developing guidance on internal control reviews;
- (h) Developing guidance on determining minimum sample sizes for substantive testing of balances and transactions;
- (i) Reporting by auditors on service organisations such as investment custodians, and determining sample sizes for testing at service organisations;
- (j) Improved guidance on performing substantive analytical procedures;
- (k) Improved guidance on the use of, and reliance on, a company's experts and the auditor's own independent experts;
- (l) Guidance for determining sample sizes across managed investment schemes with a common responsible entity;
- (m) Improved guidance for the use of, and reliance on, auditors of components in a group;
- (n) Guidance for the use of, and reliance on, auditors of joint ventures and associates; and
- (o) Reliance on internal auditors.

We are also working with the AUASB on the development of an updated pronouncement to provide guidance to the auditors of compliance plans for registered managed investment schemes. We wrote to the AUASB in this regard last year.

### **Question 13**

What mechanisms are in place for auditors to raise concerns with ASIC? Do auditors actually report specific concerns about an audited entity to ASIC?

### **Answer**

There are a number of provisions in the Corporations Act and other legislation requiring auditors to report suspected contraventions of legislation and other requirements of law to ASIC. There is protection for auditors reporting matters in the form of qualified privilege (ie the company concerned cannot sue the auditor).

We have a regulatory guide to assist auditors in this area and will be issuing an updated version in the next couple of months. We focus on the compliance by audit firms with these reporting requirements in our audit firm inspections, and in our audit surveillance and enforcement activities.

**Question 14**

How would ASIC characterise the level of coordination and consultation between ASIC, the FRC and the AUASB on audit quality issues?

**Answer**

We have strong communication with both the FRC and AUASB on audit quality matters.

In addition to ad hoc meetings and discussions on specific matters, and written submissions, our Senior Executive Leader, Financial Reporting and Audit meets quarterly with the Chairman and Executive Director of the AUASB to discuss audit quality issues. We also copied our submissions to the IAASB to improve the auditing standards (see response to question 3 above) to the AUASB Chairman.

One of our Commissioners is a member of the Financial Reporting Council and its Audit Quality Committee. Our Senior Executive Leader, Financial Reporting and Audit has spoken to the full FRC on audit quality and meets with the Chair of the FRC on matters such as audit quality.

**Question 15**

Is a company restricted from acquiring consulting and tax advisory services from the same firm that it uses for audits? If not, is there a conflict here? Can an audit firm be sufficiently sceptical of practices implemented by a company as a result of advice given by other areas of the same audit firm?

**Answer**

The provision of non-audit services may have the potential to affect an auditor's independence, objectivity and exercise of professional scepticism, as well as the perceptions of investors and other financial report users who rely on the independent audit report.

There is a general auditor independence requirement under Chapter 2M of the Corporations Act that requires auditors not to be in a conflict of interest situation in relation to an audited body. While there are no specific provisions in the Act prohibiting the provision of consulting and tax advisory services to audit clients, the directors' report of a listed company is required to contain details of amounts paid or payable to the auditor for non-audit services during the year. This must be accompanied by a statement whether the directors are satisfied that the provision of non audit services is compatible with the general independence requirement and the directors' reasons for being satisfied that the requirements were not compromised.

The professional ethical code of the ICAA, CPAA and the Institute of Public Accountants also has the force of law through legally enforceable auditing standards.



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The ethical code contains some specific provisions in relation to the provision of non-audit services. This code is based on a code prepared by the International Ethical Standards Board for Accountants (“IESBA”).

### **Question 16**

Does the Australian approach differ to that in the US and Europe?

### **Answer**

Specific provisions were introduced in the US in relation to non-audit services under the Sarbanes-Oxley Act of 2002 to prohibit the following non-audit services being provided by a firm to an issuer audit client unless approved in advance by the issuer’s audit committee:

- (a) bookkeeping or other services related to the accounting records or financial statements of the audit client;
- (b) financial information systems design and implementation;
- (c) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- (d) actuarial services;
- (e) internal audit outsourcing services;
- (f) management functions or human resources;
- (g) broker or dealer, investment adviser, or investment banking services;
- (h) legal services and expert services unrelated to the audit; and
- (i) any other service that the Board determines, by regulation, is impermissible.

Preapproval is not required where the services are in aggregate less than 5% of the total amount of fees paid by the issuer to its auditor during the year in which the non-audit services are provided. The services must still be brought to the attention of the audit committee.

In the EU, proposals under consideration include:

- (p) prohibiting audit firms from providing non-audit services to their audit clients (eg tax services, bookkeeping, internal control design, valuations, actuarial and legal services, internal audit); and
- (q) audit firms with more than one-third of annual audit revenue from large public interest entities and in a firm network with more than €1.5bn of EU annual audit revenue not be permitted to provide non-audit services to public interest entities (whether or not audit clients) or be part of a network providing non-audit services in the EU.

**Question 17**

Mr Medcraft, at the last hearing you commented that the lack of professional scepticism was a global problem. Are you aware of any work being done internationally to improve audit quality?

**Answer**

There are a range of contributors to both professional scepticism and audit quality more generally. As mentioned in response to question 1, these include firm culture; experience and expertise of auditors; firm quality control programmes; accountability of partners for audit quality; auditor independence (such as auditor rotation, fee dependence, and provision of non-audit services to audit clients); the liability regime for auditors; quality auditing standards; and independent audit firm oversight.

Professional scepticism was one of the three key themes in our last two public audit inspection reports and was the subject of an article by our Senior Executive Leader, Financial Reporting and Audit in the ICAA and IPA journals in 2010. Our most recent public audit inspection report covers both our findings in the area and our possible solutions on audit quality, including specific discussion of professional scepticism. Further, we have asked the Big 6 firms in Australia to prepare action plans to improve audit quality, in each of the three areas broad areas highlighted in our last report, including professional scepticism.

Audit oversight regulators in other major jurisdictions have also identified professional scepticism as an area of focus and have had similar findings to ASIC. Those regulators have also been working with the firms to improve audit quality in this area.

Through the International Forum of Independent Audit Regulators (“IFIAR”), we are working with other audit oversight regulators to improve global audit quality. The 6 largest firms internationally will be presenting action plans to improve audit quality to a meeting with an IFIAR working group (of which our Senior Executive Leader, Financial Reporting and Audit) is a member in June 2013. Professional scepticism is one of the subjects that has been discussed with the firms over the last two years.

Auditing standard setters have also issued some staff guidance for auditors on professional scepticism. On 4 December 2012, the US Public Company Accounting Oversight Board issued Staff Practice Alert No.10 Maintaining and Applying Professional Skepticism in Audits. In August 2012, the AUASB issued a staff bulletin on professional skepticism which was similar to a staff questions and answers document issued by the IAASB in February 2012.

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**Question 18(a)**

In our report on Trio Capital, we recommended that the government investigate options to improve the oversight and operation of managed investment schemes compliance plans and compliance committees. Is ASIC aware of any work that has been done on this?

**Answer**

We understand that the Government has accepted recommendation 7 of the Report by the Parliamentary Joint Committee on Corporations and Financial Services into the collapse Trio in relation to compliance plans and compliance committees. Specifically, on 26 April 2013, the Minister for Financial Services and Superannuation announced the Government will consult on ways to enhance compliance processes including considering the need for more detailed compliance plans, legislating minimum requirements (such as experience and qualifications), qualitative standards for compliance plan auditors and oversight of the appointment of compliance committee members.

**Question 18(b)**

In your submission to the Trio inquiry, ASIC provided a forward work plan which identified regulatory options for improving the quality of compliance plan audits. Can you outline how ASIC's work in this area has progressed?

**Answer**

Since the Parliamentary Joint Committee on Corporations and Financial Services into the collapse Trio published its report in May 2012, we have undertaken a number of pieces of work to improve the quality of compliance plan audits. These include:

- (a) We have conducted a further 4 compliance plan audit inspections.
- (b) We have written to the Auditing and Assurance Standards Board (AUASB) to advise them of areas that could be included in auditing and assurance standards and guidance statements for compliance plan audits.
- (c) We are working with AUASB to explore the possibility of a new standard or guidance statement for compliance plan audits. In our view, AUASB standards or guidance may assist auditors in better understanding their obligations and conducting quality audits.
- (d) We have been undertaking a review of our regulatory guidance on compliance plans. We also note the Government has accepted recommendation 7 of the Report by the Parliamentary Joint Committee on Corporations and Financial Services into the collapse Trio in relation to compliance plans and compliance committees and will consult on

those matters. We will consider publishing a consultation paper on revisions to our regulatory guides on compliance plans after the Government has completed its consultation. We can then take any recommendations or legislative changes into account in our proposals for revised regulatory guides.

### **Question 19**

Mr Medcraft: ... Our investigation continues. Last week ASIC permanently banned Astarra chief investment strategist, Mr Eugene Liu, from providing financial services. This brings to 11 the number of people who, as a result of our investigation, have either been jailed, banned or disqualified or have removed themselves from the industry, for a total of more than 50 years.

**Senator BOYCE:** Of those 11, how many were jailed, how many were banned, how many were disqualified and how many have removed themselves from the industry? Can you split that up?

### **Answer**

- (a) Jailed: 1
- (b) Administrative bannings (two bannings are currently on appeal): 3
- (c) Removed themselves from the financial services industry and/or acting as a company director: 7
- (d) Agreement not to practice as a registered auditor: 1

Total: 12