

28 October 2019

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Inquiry into Regulation of Auditing in Australia
PO Box 6100
Parliament House
Canberra ACT 2601

By email: corporations.joint@aph.gov.au

Dear Committee Secretary,

The Australian Investment Council values the opportunity to put forward this submission into the Parliamentary Joint Committee's Inquiry into the Regulation of Auditing in Australia (the Inquiry).

The Australian Investment Council is the voice of private capital in Australia. Private capital investment has played a central role in the growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy each year. Our members are the standard-bearers of professional investment and include: private equity, venture capital and private credit funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers.

Private capital investors in this market manage more than \$30 billion of investment capital on behalf of investors in Australia and all over the world. Our members invest in a wide range of Australian businesses from early stage tech and biomedical start-ups, through to established and mature businesses across every industry sector of the economy. Our members actively work with the businesses they back to increase their workforce, boost sales growth, and invest in new technology and innovation to allow them to expand into new markets domestically, regionally and internationally.

Audit as a key pillar in driving investment decisions within our market

Our members invest billions of dollars each year into Australian businesses across every sector of the economy. The allocation of capital into businesses is guided by open and contestable markets that have access to timely, comparable and relevant information upon which analysis can be conducted, and decisions made.

Investing significant amounts of capital into businesses is underpinned by a comprehensive governance framework between the fund managers who are investing capital into businesses, and the investors who entrust those managers to exercise professional skill and judgement in carrying-out their role.

A stable, transparent and robust business policy and regulatory framework is vitally important to maintaining a high degree of confidence in public and private markets, and that the reporting obligations which exist under international and domestic accounting standards, and the Corporations Act, are satisfied.

In our view, Australia has for some time been recognised globally as having a world-class financial reporting system, within which the role of auditors and the provision of assurance is central.



Maintaining a strong regulatory framework around audit quality

Delivering consistent audit quality across the market in Australia is important to achieving the ideals described above, and instilling and maintaining confidence in public and private markets.

For many years now, there has been considerable debate about whether or not there has been a deterioration in audit quality in Australia.

There will be often be differing opinions about this matter, given the subjective nature of professional judgement and the weight placed on various considerations that form the basis upon which judgement is exercised.

While, in our view, there is no compelling evidence to suggest there exists a systemic failure in the delivery of quality audit and assurance work in the market, there does appear to be a degree of consensus within the audit profession – and the key regulatory and standard-setting bodies – that audit quality should continue to be challenged in order to ensure that the delivery of audit and assurance is improved on an ongoing basis wherever possible.

Firms delivering audit services in the market should ensure that the performance metrics of key personnel are tied closely to the delivery of high quality audit outcomes within the market. The role of the key market regulator in this area – the Australian Securities and Investments Commission – is clearly important.

Evidence over many years suggests to us that the ASIC audit firm inspection program, along with the financial reporting surveillance initiative, have delivered meaningful and ongoing improvements in the delivery of high quality audit outcomes within financial markets. It is important that ASIC is provided with sufficient resources in order to continue to carry-out an effective compliance monitoring and review program, in-line with the expectations of market participants.

Over recent years, ASIC's implementation of enhancements to its audit inspection program – through its Close and Continuous Monitoring team and the Corporate Governance Taskforce – provides evidence of the capacity for the key market regulator to continue to implement changes to monitoring, review and enforcement initiatives which will ultimately deliver downstream benefits to end-users and financial market participants. Consideration should be given to implementation of firm-wide quality management processes, in addition to individual file inspection processes. In our view, such an approach would aid in providing greater confidence and understanding of ASIC's role in monitoring audit quality within the market.

Non-audit services delivered to audit clients

The complexity of the market environment in which businesses operate today is relevant to any discussion about the role of auditors and the delivery of quality audits within markets. Today, perhaps more so than ever before in history, businesses often require access to specialist knowledge, skills and advice to assist them in navigating their own regulatory compliance obligations, and to continue to operate as efficiently and productively as possible.

In our view, arguments that call for a general prohibition or tight restrictions on the capacity for auditors to provide non-audit services to their audit clients is flawed. There is no evidence, with which we are aware, that confirms that such an approach would deliver any meaningful downstream benefits to businesses or market participants more broadly. In fact, as set out below, there is likely to be a compelling argument that such measures would ultimately have an adverse effect in respect of maintaining and improving the quality of audit in Australia.



It is important to acknowledge that non-audit services can typically fall into three distinct categories:

1. Services required by legislation or contract to be undertaken by auditors of the business
2. Services that are most efficiently delivered by existing auditors, and
3. Services that could be provided by another firm who is not the auditor.

The question around non-audit services generally relates to whether or not the provision of such services in any way impedes or compromises the independence of auditors in the carrying out of their role with the business.

In Australia, the Code of Ethics for Professional Accountants (referred to as APES110, and which mirrors international ethical codes set by the International Federation of Accountants and the International Ethics Standards Board for Accountants), sets out the fundamental principles of ethics for professional accountants, recognising the profession's responsibility to at all times uphold the public interest in everything it does.

The ethical conduct framework set out in this standard goes some way towards ensuring that the provision of non-audit services to audit clients is governed by a set of principles and a conceptual framework that guides auditors to make decisions that avoid the risk of compromising or impeding independence.

There are compelling arguments in support of maintaining a capacity for auditors to provide certain non-audit services to their clients in circumstances where there would not be any impact on the independence of auditors carrying out their role.

Seeking to impose restrictions or prohibitions on the provision of certain non-audit services is likely to create adverse downstream consequences which would impact on the underlying quality of audits conducted in the market. The provision of certain non-audit services by auditors delivers significant value to businesses because it facilitates the building of greater knowledge and insight into the operations of the business, allowing for auditors to increase the likelihood of detecting key risks and material misstatements in financial accounts in the future.

The provision of non-audit services typically involves drawing upon the skills and expertise of other specialist teams within the audit firm. There are considerable benefits to businesses being able to access the breadth of skills embedded within a multi-disciplinary firm, who are often in a very strong position to be able to utilise the knowledge and insight they have into the audited business to assist them to deliver targeted advice that is both more relevant and efficient in terms of cost.

To the best of our knowledge, there has not been any conclusive research completed that evidences a correlation between the provision of non-audit services and audit failure. For that reason, along with the reasons set out above, we do not believe there should any significant change to the current regulatory and professional standards frameworks that govern the provision of non-audit services by auditors.

Continuing to enhance the role of audit to benefit Australia's long-term economic ambitions

The role of audit in maintaining confident and informed financial markets is vitally important. Every day, across every industry sector of the economy, investment decisions are being made on the basis of information that is made available by businesses to the market at large, or to specific stakeholders or segments of the market.

The reliability of that information is essential. Australia has enjoyed a reputation globally for having strong and robust legal and regulatory frameworks that work in combination with one another to create a competitive open market economy that has the capacity to attract domestic and offshore investment. As the participants in this Inquiry will be aware, Australia's economy relies in significant measure on the capacity of our market to continue to attract offshore direct and indirect investment from all over the world. In order for us to do that, we must maintain and uphold the strongest principles possible around our market practices and regulations that instil confidence and certainty amongst the international community of investors.



Continuing to promote an environment within the audit profession that upholds quality at its heart is, in our view, an essential ingredient in maintaining the capacity of our private capital investment industry to continue to invest billions of dollars into Australian businesses across every sector of the market.

We encourage the Committee to evaluate carefully the current frameworks in place across the audit profession, and where opportunities are identified to consider the adoption of reforms that will have the effect of improving audit quality and the associated downstream benefits for financial markets and the economy at large, they should be canvassed broadly across all stakeholder groups within the market.

We would be very pleased to provide further information to the Committee in support of the points made in our submission, or respond to any specific questions arising from the Inquiry. You can reach me by email at ceo@aic.co or by phone on 02 8243 7000.

Yours sincerely

Yasser El-Ansary
Chief Executive