

Deloitte.



**Deloitte submission to the inquiry into
the regulation of auditing in Australia**

28 October 2019

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Deloitte Australia has been in the professional services business for more than 128 years. We are a leading provider of audit and assurance, consulting, financial advisory, risk advisory, tax and legal services. The Deloitte global network includes member firms located in more than 150 countries, employing over 300,000 people – in Australia this is more than 10,000 professional staff. At Deloitte Australia our purpose is to make an impact that matters. We are driven by our desire to create positive outcomes for our clients, people and communities. Everything we do is with intent - the intent to make a meaningful difference.

Introduction

Thank you for the opportunity to provide a submission to the inquiry into the regulation of auditing in Australia. We support the work of the Parliamentary Joint Committee on Corporations and Financial Services to enhance informed transparency and to enable strong, effective regulation of audit. We look forward to assisting the Committee in its important work and participating fully.

We are deeply committed to maintaining trust in capital markets as the bedrock of our national economic stability and prosperity, and we are proud of the role Deloitte plays to help protect investors, stakeholders and the public trust. Audit, as one component of the broader financial reporting ecosystem, is critical to this. We have a long history of delivering audit services globally and in Australia; audit is core to our purpose, strategy and heritage as a leading professional services firm now and into the future.

As one of the nation's largest employers of graduates with a significant investment in ongoing training and development, we are also proud of our role in developing the next generation of auditors and business leaders. We recognise we must deliver consistently high-quality audits – and that there is always more we can do to improve audit quality. This is our commitment globally and in Australia.

An overview of our submission and key points

We understand the Committee is reviewing the regulation of auditing in Australia through this enquiry by exploring a broad terms of reference, and is seeking a diverse range of submissions and perspectives. With that in mind, we have focussed our submission on the terms of reference that we can best contribute to.

Our submission is structured as set out below with reference to the most applicable terms of reference highlighted, noting that we welcome the opportunity to further discuss these issues and related topics:

Section	Key points
1. Our commitment to improving audit quality <i>(Terms of Reference 4)</i> <i>Page 6</i>	Australia continues to have effective, efficient and reliable audit services of good quality. At the same time, we acknowledge that audit in Australia can and should continually seek to evolve and improve. We are investing in audit transformation both in Australia and globally, and we prioritise continuous audit quality improvement. Competition for the largest audits in the audit market in Australia is fierce, and we are deeply committed to our audit business. Competition results in appropriate pricing, and the level of pricing does not currently compromise quality.

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2. Shifts that are challenging the role and scope of audit

(Terms of Reference 3, 4, 6 and 7)

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Technology disruption, new business models and a growing expectations gap are driving change in traditional audit and demanding greater transparency in financial reporting, business performance and changes to accounting and auditing standards.

Audit remains a highly valued service but must adapt to address new and increasingly complex businesses. Our regulator, our stakeholders and the audit profession (including Deloitte) need to constantly evolve because the entities we audit are changing along with the markets and industries in which they operate.

The opportunities for technology to improve audit quality are significant. For example, we recognise and support the opportunity to enhance overall financial reporting quality, increase transparency, drive regulator efficiencies and lower information processing costs through the widespread adoption of xBRL and digital reporting technology.

3. The increasing need for specialist skills in quality audit

(Terms of Reference 4, 6 and 12)

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An increasing range and depth of skills and expertise are required in order to undertake a complex audit. Audit is no longer just about the numbers. It includes an understanding and examination of complex risks and drivers that can impact an entity's long-term value. We believe multi-disciplinary firms – firms that provide a range of services beyond audit – are best placed to deliver high quality audits that address the increasing complexity and scale of modern business.

Multi-disciplinary firms are equipped to challenge complex companies, attract and retain specialist talent and develop the skills, expertise and global consistency needed for good quality audits.

4. Audit's role in the financial reporting ecosystem

(Terms of Reference 5 and 6)

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We support open discussions as a basis for understanding what a broad range of stakeholders need from audit and the wider financial reporting ecosystem – and we welcome change that will enhance audit quality and competition, improve trust in financial reporting and corporate governance, and strengthen the independence of the auditor.

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5. Addressing perceived conflicts of interest between audit and 'consulting services'

(Terms of Reference 1 and 2)

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Audit remains a critical component of our business and a source of significant investment and leadership focus. Audit is a valuable and profitable business for our firm – other services are not required to 'subsidise' our audit business line, nor do we use audit services as a 'loss leader' to generate revenue from other services to the entities we audit.

We recognise that there can be perceptions of conflicts of interest and compromised auditor independence. Deloitte takes this issue very seriously, and we have robust independence and conflicts policies and systems in place that are in many cases more stringent than what professional standards or regulations dictate. These policies are requirements of all of our partners and staff.

6. Enhancing accountability through regulation

(Terms of Reference 5)

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We are open to evaluating regulatory frameworks that have a proven impact in ensuring the integrity of the financial reporting ecosystem and driving measurable improvements in audit quality.

To that end, we believe that there have been improvements in financial reporting and improved audit quality following the adoption of the Sarbanes-Oxley Act in the United States, and we support discussion on how similar regulatory frameworks can enable enhanced accountability, greater transparency and audit quality across the ecosystem in Australia.

7. Our commitment to an effective regulator and regulatory regime

(Terms of Reference 8, 10 and 11)

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We support a capable and well-resourced regulator and are committed to continuing to engage with ASIC to support ongoing audit quality improvement in Australia.

1. Our commitment to improving audit quality

Terms of reference 4 seeks information on audit quality. In this section we explain Deloitte's commitment to audit quality through our continuous improvement and audit transformation programs.

1.1 Introduction

Firstly, we think it is important to address the notion that appears to underpin the Committee's terms of reference that audit quality in Australia may be compromised. As mentioned in ASIC's audit inspection program report for 2017-18 (and referenced in ASIC's submission to this Inquiry), its risk-based financial reporting surveillance has resulted in material changes to net assets and profits in 4-5% of the financial reports reviewed, which it states is comparable to other major jurisdictions.¹

In its audit inspection findings, ASIC notes that the cases in which it identified and raised financial reporting concerns are generally included in the 4% mentioned above. ASIC further recognised the good efforts of the firms to improve audit quality.²

It is important to also note the relationship between audit quality and corporate performance. While we do believe that audit has a critical role to play in upholding trust and confidence in financial markets and is an essential early warning system, even the best audit cannot prevent all forms of corporate collapse. Companies fail for many reasons, and there is no systemic, causal link between corporate failure and audit quality in Australia.

ASIC recently stated that audit firms need to continue to work on "improving audit quality and the consistency of audit execution".³ We agree with this wholeheartedly and recognise that our audit quality has not always been as high as it should be. Audit quality is pivotal to the effectiveness of our organisation, and we are the first to say that we are always seeking to improve it.

1.2 Our commitment to continuous audit transformation

At Deloitte, our purpose is to make an impact that matters for clients, our people and our communities. For audit, this means a focus on delivering independent, high quality audits to support the integrity of capital markets. This requires us to continuously build leading capabilities and make contributions to shaping the audit profession.

To this end, we are continuing to undertake a significant transformation of audit, with a focus on delivering high-quality, relevant audit services as a top priority. Our transformation is equally driven by our deep commitment to provide the entities we audit with consistent, high quality audits, and the need to address the significant changes facing the audit profession as a whole. Audit quality is not a journey with a fixed destination but something we work constantly to improve, and we are proud of our interaction with governments, regulators, industry bodies and standard setters to ensure that audit meets the ongoing requirements of stakeholders and is fit for the future.

1. Australian Securities and Investments Commission, Regulation of Auditing in Australia: Submission 16, October 2019, p.6

2. Australian Securities and Investments Commission, Report 607: Audit inspection program report for 2017-18, January 2019, p.11, <https://download.asic.gov.au/media/4990650/rep607-published-24-january-2019.pdf>.

3. Australian Securities and Investments Commission, Regulation of Auditing in Australia: Submission 16, p.11

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Deloitte has already invested over \$1 billion globally in audit transformation with a range of strategic and operational priorities. We continue making these investments because audit is core to our business now and in the future. At the heart of this investment is the Deloitte Way Workflow, which establishes a globally consistent way of performing audits. There are three principles at the heart of the Deloitte Way Workflow:

- **Standardisation:** a consistent set of tools and procedures across our audit practice with a shared framework for applying our judgments.
- **Centralisation:** putting our standardised approach into action by consolidating key activities and tools, and applying shared tools, processes and other resources in a uniform way.
- **Digitisation:** applying technologies to enable our standardised processes and consistent approach, making our audits more comprehensive by assessing all the relevant data.

The Deloitte Way Workflow is transforming the way audits are undertaken and driving consistency that allows our auditors to deliver audits with clarity and confidence, while allowing for a greater focus on higher risk areas with increased opportunity to apply professional judgment and critical thinking.

1.3 Monitoring of audit quality

Over the last three years, we have also invested heavily in our Audit Quality Monitoring and Measurement (AQMM) program. The objectives of AQMM are to:

- Transform the way audit quality is monitored and measured and how audit deficiencies are resolved, and
- Enhance our internal system of quality control.

The AQMM program is focused on:

- Continuous, consistent, and robust monitoring of completed and in-flight engagements
- Obtaining a detailed understanding of the nature and cause of deficiencies identified (by our internal monitoring programs and by ASIC in its inspection program) and timely execution of corrective actions, and
- Greater transparency and consistency in reporting key measures of audit quality.

1.4 Our commitment to continuous learning and development

Staff training and a culture of continuous learning are also key to audit quality. Deloitte has enhanced its technical audit curriculum to consistently build the proficiency required by practitioner level. We have a mandatory audit and accounting technical learning curriculum, targeting learners by level, using a blend of live instructor-led and digital on-demand courses as well as on-the-job activities. Our learning and development curriculum far exceeds the training hours required by regulation and professional standards and is designed to upskill our audit staff in the areas of audit and accounting technical proficiency, specialised audit and leadership capabilities.

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In financial year 2019 alone, we invested over \$10 million in Australia on learning and development for our audit and assurance staff to build audit capabilities across all career levels from graduates to partners. To that end, during financial year 2019 our audit practitioners completed over 67,000 hours of learning and development.

Specialised training primarily comprises global mandatory training (both audit and accounting) which is specific to each career level. These training curricula are also supplemented with locally developed accounting technical training which is more on-demand and focuses on various new accounting standards. We have also established specific learning requirements for specialists working on audit engagements to support their knowledge and understanding of the audit process.

Our learning and development investment is core to our commitment to audit quality as well as our talent value proposition to support our staff with leading development opportunities to enable their personal and professional development – whether their career progression is with Deloitte, a competitor firm or in industry or government.

We welcome discussions on our approach and commitment to audit quality now and in the future.

2. Shifts that are challenging the role and scope of audit

Terms of reference 3, 4, 6 and 7 seek information on the issue of the level of competition between audit service providers, audit quality, the changing role of audit, and the effectiveness of audit in detecting fraud and misconduct. All of these terms of reference reflect changes in expectations in the market that are challenging the role and scope of audit.

The contemporary business environment has become increasingly complex, and businesses are changing rapidly as a result. Mega shifts including corporate globalisation, regulatory change, stakeholder expectations, and technological advances are driving rapid change in the form of new business models, with pressure on business from investors and other stakeholders for a more holistic definition of performance.

The audit profession is not isolated from these changes and is in a period of adaptation. Simply, performing an audit is more complex than ever – what is being ‘counted’ has shifted from the days of samples of physical documents within cardboard boxes in storerooms to intangible assets that can be difficult to identify and measure.

2.1 Technology drives change and opportunity

Technologies such as artificial intelligence, analytics, blockchain, robotics and cloud-based platforms offer further opportunities to transform audit processes, increase transparency and improve audit quality. These technologies are at the core of our own audit transformation program for this reason.

We are already seeing these opportunities transition from possibility to reality, enabling a shift from traditional sampling to continuous and full volume auditing through extraction and comprehensive analysis of structured and unstructured data. As corporate systems continue to mature, easier data extraction is available, and the use of analytics is expanding across the types of balances and classes of transaction.

The opportunities for these technologies to improve audit quality and address part of the expectations gap are significant. Examples include the use of general ledger analytics to inform risk assessments and to perform journal entry testing, or the use of real time analytics to detect material fraud. Increased assurance is also enabled in cases where large sample sizes are required in high volume businesses and those with limited controls. These technology driven improvements and efficiencies mean that human effort can be focussed on complex assessment that requires significant experience and judgment, areas generally with the greatest risk of misstatement.

We further note and support the submission to this Inquiry by Professor Peter Wells from the University of Technology Sydney which provides details of the opportunity to use eXtensible Business Reporting Language (xBRL) to enhance overall financial reporting quality, increase transparency, drive regulator efficiencies and lower information processing costs.⁴

There remains significant opportunity to leverage technology to improve quality and transparency across the full financial reporting value chain (including audit), and we would welcome further exploration of this.

4. Peter Wells, Regulation of Auditing in Australia: Submission 7, September 15, 2019, p.4.

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2.2 Societal expectations are pushing audit for more

What society expects of business is fundamentally changing, and the kind of assurance that is needed is evolving with it. It is no longer only about what is required by standards and laws. This has driven an increasing 'expectations gap' between the role audit is intended and required to play versus the role that some expect audit to play. To that end, there is a gap between the audit product dictated by current audit and accounting standards and the expectation by some that audit provide more – from additional assurance across a business' functions to enhanced perspectives on fraud and misconduct, to judgments of long-term financial viability.

Stakeholders now look to auditors for deeper insights that focus on risk, operations and financial performance to better understand an organisation's future viability, as well as insights that contribute to a forward-looking agenda.⁵ Forbes Insights stated "several investors suggested that it would be helpful for the auditor to provide insightful commentary on company quarterly forecasts or guidance, providing some "justification" for that forward-looking information."⁶ A recent Deloitte survey in the United States also found that 73% of C-level executives feel that audits should be used for more than just financial statement reporting.⁷

While an expectations gap has existed for decades, we believe it is time to move beyond the effort to continue to explain to investors and broader stakeholders what they should expect. Rather, it is time to take action to address the causes driving this gap. We note that any discussion about further regulatory reform requires consideration of the whole ecosystem of corporate governance and reporting (in Australia and globally) and an understanding of the interrelationship between the participants. If audit (or another capability) is to meet some or all of these expectations, not only do accounting and auditing standards need to change, but also the question of who bears this cost must be considered and associated policy options debated. We welcome this debate for the broader benefit of enhanced transparency.

Likewise, as we explore the needs and expectations of a broad set of stakeholders beyond investors, we welcome open discussion on how to meet expectations for a holistic and forward-looking view of the health and resilience of companies, including assessment of viability, risks, business strategy and clarification on fraud detection and reporting – whether this is delivered by an enhanced audit or another mechanism.

We note that these shifts require more than just audit skills. Management teams' capabilities will also have to adapt and develop to support any changes. Likewise, appropriate standards have to be developed and implemented to support both management and auditors to perform their roles consistently and effectively.

5. Forbes Insights, Future role of audit: a more insightful audit for a more complex world, 2014, p.1, https://www.forbes.com/forbesinsights/future_role_of_audit/index.html.

6. Forbes Insights, Future role of audit: a more insightful audit for a more complex world, 2014, p.9.

7. Deloitte, Audit Value Survey, 2018, p.6, <https://www2.deloitte.com/us/en/pages/audit/articles/audit-value-survey.html?id=us:2el:3dc:auditinnovceros:awa:aud:072018>.

3. The increasing need for specialist skills in quality audit

Terms of reference 3, 4 and 6 focus on competition, audit quality, and the changing role of audit. Each of these issues relates to the increasing need for specialised skills in the auditing profession.

3.1 Introduction

As organisations transform and become more technology-focused, enter new markets and operate across borders, the range of expertise required to deliver quality audits has expanded and become a more critical driver of audit quality. Today's audits can require professionals with specialisation in valuations, financial and economic modelling, financial instruments, tax, technology systems, data and internal controls. Accordingly, the recent Public Company Accounting Oversight Board's (PCAOB) release around amendments to its standards for using the work of specialists indicated that over 60% of audits use specialist skills.⁸

Further, Australian and international auditing standards require auditors to determine the expertise needed to obtain sufficient audit evidence for matters that relate to expertise in fields other than accounting or auditing.⁹

For these reasons, we believe multi-disciplinary firms – firms that provide a range of services beyond audit – are best placed to deliver high quality audits that address the increasing complexity and scale of modern business. These firms are better equipped to understand and test complex companies, attract and retain specialist talent, and develop the skills, expertise and global consistency needed. Further, these firms are also better positioned to offer a broad range of career paths and ensure they attract and retain the best talent to the profession.

A report of a global alliance of accounting bodies including the International Federation of Accountants (IFAC), the Association of Chartered Certified Accountants (ACCA) and Chartered Accountants Australia & New Zealand (CAANZ) noted, "The increasing complexity of business and reliance on technology has strengthened the importance of committed and qualified audit professionals and resulted in a greater demand for specialists."¹⁰

More diverse firms are able to consistently deliver both: a large population of qualified and skilled audit professionals who access ongoing training and development as well as the necessary breadth and depth of specialist capabilities to readily draw on. These specialists, as employees, are already compliant with required independence obligations. To that end, our audit practice benefits from access to a broad range of technical and industry specialists, with over 380 specialists in Australia providing audit support roles. At the same time, our advisory businesses benefit from the regulatory experience, deep accounting skills and leadership capability that our audit practice brings to our broader firm.

Multi-disciplinary firms also have greater financial capacity and are better positioned to objectively and robustly challenge the entities they audit and to make significant investments

8. PCAOB, Release 2018-006: Amendments to auditing standards for auditor's use of the work of specialists, 2018, p.34, <https://pcaobus.org/Rulemaking/Docket044/2018-006-specialists-final-rule.pdf>.

9. Auditing and Assurance Standards Board, Auditing Standard ASA 620 Using the Work of an Auditor's Expert October 2009.

10. ACCA, CA ANZ and IFAC, Audit Quality in a Multidisciplinary Firm, 2019, p.5, <https://www.ifac.org/system/files/publications/files/Audit-Quality-in-a-Multidisciplinary-Firm.pdf>

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required in the systems, processes and technology to do so effectively. We have noted Deloitte's over \$1 billion global investment in audit innovation, training and technology. This investment is increasing our audit capacity – and would simply not be possible without the scale of our global multi-disciplinary firm.

For these reasons, we do not support measures that recommend audit only firms either in Australia or elsewhere.

4. Audit's role in the financial reporting ecosystem

Terms of reference 5 and 6 seek information on Australian and international reviews of auditing, and the changing role of audit. In this section we discuss the role of audit and its global context, with reference to international reforms.

External audits do not exist in isolation. Audit is only one part of the financial reporting ecosystem, with other key parties including management, directors, regulators and standard setters also having roles to play. Audit provides a critical link between entities that prepare financial reports and the users who rely on them. So in defining the role of audit, it is critical to also define the responsibilities of those who play a vital role in ensuring complete, accurate, and transparent financial reporting to serve the public interest.

Broadly, the roles within the financial reporting ecosystem are illustrated in Diagram 1 and include:

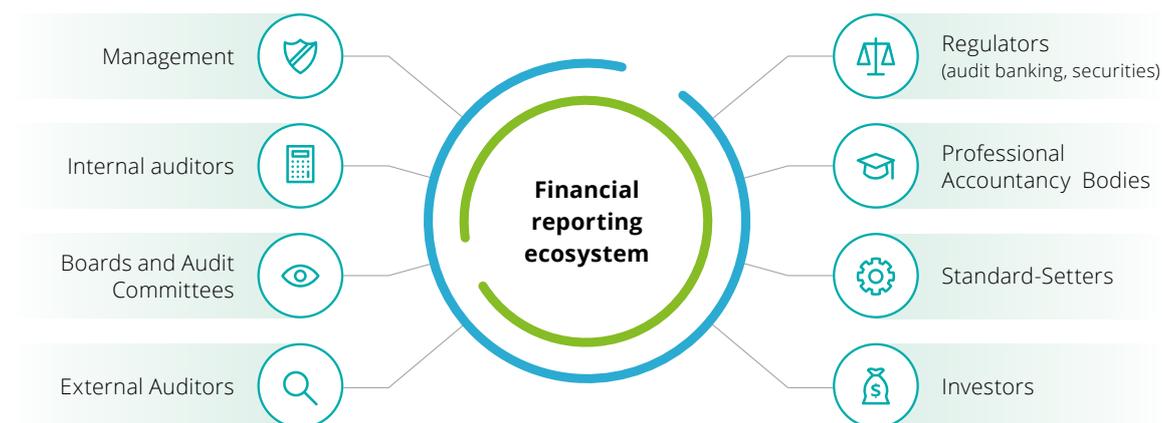
- **Company management:** conduct the day to day affairs of the entity, including preparation of the management accounts and the financial reports. Management also assess the controls, measures and system improvements required for financial reporting, and ensure the controls are implemented sufficiently and operating effectively for the complexity of the business and its strategic objectives. In accordance with section 295a of the Corporations Act 2001 (the Act), for listed entities the CEO and CFO must provide a declaration in relation to the financial statements to the entity's directors.
- **Directors:** responsible for the financial report and whether the company has the necessary systems, processes and controls. Directors should ensure that the entity has appropriately skilled personnel responsible for financial reporting, and a culture within the organisation that values honesty, quality and transparency. They must engage in open dialogue both with management and the auditor, and it is essential that boards critically evaluate information and risks facing the entity. In the context of the audit, directors must understand the cause of auditor findings and observations and ensure that management responds appropriately. They should also make sure that they are comfortable with the quality of the audit and that they have created an environment in which the audit can be properly performed while overseeing the independence and effectiveness of the audit process.
- **Audit committees:** can play an important role in the financial reporting process and in supporting and promoting audit quality and the role of the board more generally. They can also play an important role in recommending the appointment of an appropriately qualified and resourced auditor, in determining appropriate auditor remuneration and overseeing auditor independence.
- **Auditors:** form an opinion about whether the financial report complies with accounting standards and gives a true and fair view, including about certain other matters (section 307 of the Act) as well as report to members (section 309 of the Act).

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- **ASIC:** are responsible for registering company auditors, assessing compliance with financial reporting and audit requirements of the Act, and taking administrative or enforcement action where the circumstances warrant.
- **Accounting and auditing standard setters:** are responsible for developing Australian Standards based on the relevant international standards with a strategic direction from the Financial Reporting Council (FRC).
- **Professional bodies:** provide support to their members and contribute to the wider profession through education and advocacy activities.

Diagram 1: Financial reporting ecosystem

All stakeholders of the financial reporting ecosystem play a critical role in ensuring complete, accurate, and transparent financial reporting in order to serve the public interest.



In Australia and globally, Deloitte supports and encourages informed debate about the role and expectations of audit in the context of the wider financial reporting ecosystem. In particular, Deloitte supports measures aimed at increasing both transparency and accountability across the ecosystem. Matters worth considering in this regard include:

- The frameworks that set out the responsibilities of management and directors and consideration of enhanced requirements and transparency to test how these responsibilities have been fulfilled.
- The degree of complexity can vary significantly for different types of entities and any proposed regulatory changes should reflect this proportionality.
- Companies can do more to ensure that the information conveyed in their public reporting is clear, succinct and understandable to a wide range of stakeholders.

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- Australia operates in a global context, with opportunities to discuss further harmonisation of standards and regulations.
- The discussion on audit quality and audit reform is playing out globally, particularly in the UK. Deloitte UK has actively participated and provided insight and commentary to Sir Donald Brydon's Independent Review into the Quality and Effectiveness of Audit, Sir John Kingman's Independent Review of the Financial Reporting Council (FRC), and the Competition and Markets Authority (CMA) Statutory Audit Services Market Study. The effectiveness of other regulatory regimes and market structures and their applicability in Australia are worth consideration.

5. Addressing perceived conflicts of interest between audit and 'consulting services'

Terms of reference 1 and 2 focus on the relationship between auditing and consulting services and potential conflicts of interest, as well as on other potential conflicts of interest. Terms of reference 3 focuses on competition in audit and related consulting services. To address these issues we first outline the relationship between audit and consulting, and then how conflicts of interest are avoided.

5.1 The relationship between audit and consulting services

We recognise that the growth of multi-disciplinary firms, who deliver both audit and a range of consulting services, has raised questions, perceived issues and speculation both in the media and other forums about the relationship between audit and consulting or advisory practices. For clarity:

- Audit is a valuable and profitable business for our firm. Other practices (such as consulting) are not required to 'subsidise' our audit business, and
- We do not use audit services as a 'loss leader' to generate revenue from other services to the entities we audit.

Firstly, audit remains a critical component of our business and a source of significant investment and leadership focus – the Deloitte network's sizable global investment in audit transformation is just one measure of this.

Audit is not just our heritage and our past; it is a key part of our forward strategy. In regard to perceptions of audit as a 'loss leader', our audit business has been as profitable as our average business line for many years. Further, and more importantly, global and Australian standards and regulations do not allow the auditor to provide independence impairing services.

Competition to undertake audits in Australia remains fierce, and we are deeply committed to attracting and retaining audit work. Because the audit market is competitive, this ensures that the audit pricing is also competitive. We believe that current pricing is appropriate and does not result in compromises to audit quality. Large scale firms produce economies of scale that reduce the overall cost on business. Audit firms without adequate size, scale, technology and expertise will likely find it difficult to achieve an equivalent level of quality at a comparable price.

In short, while we are a multi-disciplinary firm that leverages our strengths and deep specialisation to serve the entities we audit, there is little relationship between audit and consulting services by design. Deloitte auditors are evaluated solely on their audit work, and there are no incentives to sell non-audit services to the entities we audit. In fact, metrics related to the sale of non-audit services are prohibited by Deloitte policies when evaluating or compensating audit partners.

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5.2 Managing perceived conflicts of interest

We recognise that there can be perceptions of conflicts of interest and compromised auditor independence. These perceptions are mainly driven by two things: the delivery of non-audit services to the entity being audited and perceived closeness of auditors with the entities they audit. Deloitte takes this issue very seriously, both in how we comply with professional and regulatory standards and how perceptions of conflict can undermine broader trust in the capital markets we serve. We have independence and conflicts policies and systems in place that are in many cases more stringent than required by professional standards or regulations, and are requirements of all of our partners and staff.

While this issue is important it is not new. Conflicts of interest and auditor independence are governed by extensive laws and standards in Australia and internationally, including:

- **The auditor independence requirements of the Corporations Act 2001** (Divisions 3, 4 and 5 of Part 2M.4 and Section 307C): Australian laws include specific prohibited relationships between the auditor and the audited entity, with audit partner rotation requirements for listed entities. The law also sets out that the auditor must respond to conflicts of interest situations, including notifying ASIC in writing if a conflict of interest situation remains in existence more than seven days after being identified.
- **The International Ethics Standards Board for Accountants (IESBA). International Code of Ethics for Professional Accountants:** The Code contains the International independence Standards, and applies to all professional accountants, whether they are in public practice, industry or commerce. The Deloitte network is a member of an international association of accounting firms that commit to having policies and methodologies that conform to the International Code.
- **APES 110 Code of Ethics for Professional Accountants:** The Australian professional standard contains detailed auditor independence requirements, including non-audit services rules, that are legally enforceable with respect to audits conducted under the Corporations Act. The Code requires the auditor to maintain independence not only in fact, but also in appearance.
- **Australian Prudential Regulation Authority (APRA) Prudential Standards** (Prudential Standards 510 – Governance): These standards replicate the main auditor independence requirements of the Corporations Act with respect to APRA regulated entities.
- **Auditor independence rules of the US PCAOB and US Securities and Exchange Commission:** The rules are extraterritorial and must also be complied with in Australia by firms and network firms that undertake audits of entities that are subject to SEC independence rules.

5.3 Our independence quality control framework

However, rules alone are not necessarily sufficient to provide confidence that firms are independent of the entities they audit. We have also invested significantly in developing a

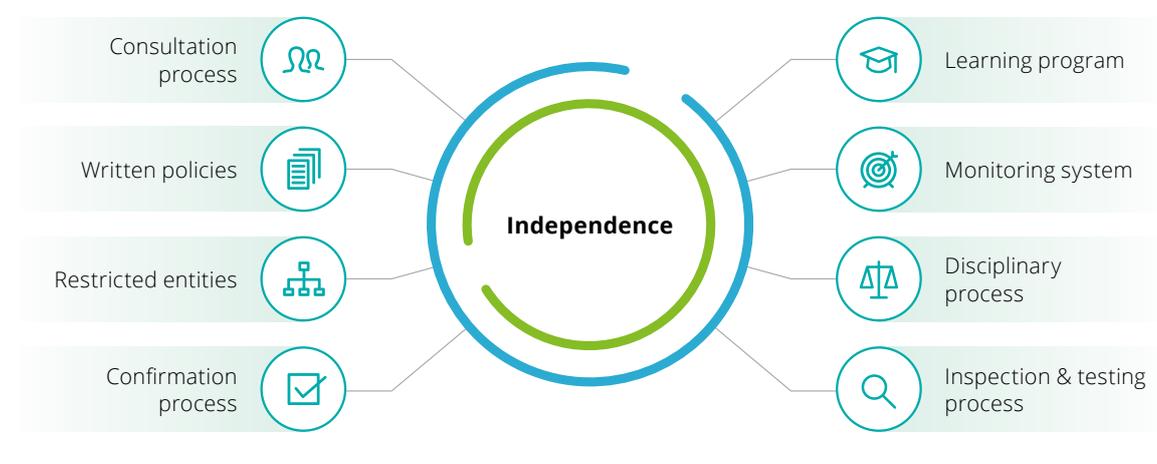
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robust independence quality control framework for ensuring compliance with all applicable laws and standards. Our independence quality controls are illustrated in Diagram 2. These include assessing, monitoring and testing of client and engagement acceptance, arms-length business relationships, monitoring of audit partner rotation requirements, personal independence requirements for our partners and staff, and procedures to identify and evaluate non-compliance with independence requirements and application of related disciplinary measures and actions (including financial penalties).

We have also invested significantly in controls and business process tools to prevent activities that could create conflicts of interest. This includes a global database of entities audited by Deloitte and our affiliates, and a global system in which the personal financial interests of partners, managers and their immediate families are recorded to ensure they do not have investments in the entities we audit around the world.

Diagram 2: Independence

Everything Deloitte does has an independence implication



5.4 Non-audit services

With respect to any request to provide non-audit services, Deloitte policies require every potential engagement to be reviewed to determine whether we have an existing audit relationship with the entity or any of its affiliates and to assess whether the proposed services can be provided without impairing independence. Providing non-audit services to an audited entity in full compliance with auditor independence requirements, laws and regulations should not present a concern.

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5.5 Perceived closeness of auditors to audited entities

We further acknowledge that there can be a risk of overfamiliarity with management arising from long term audit relationships that may create actual or perceived threats to independence. Ultimately, regulations strike the appropriate balance between maintaining independence, while being close enough to an entity to gain the cumulative knowledge and depth of insight required for a quality audit to be delivered. We believe that the existing audit partner rotation requirements in Australia, which have recently strengthened and are as strict as any in the world, strike the right balance between addressing the threats to independence created by long term relationships and the need to maintain relevant knowledge and experience to support audit quality.

5.6 Opportunities for enhancement

We welcome discussion about measures that mitigate these perceived conflicts and increase transparency. We consider the market would benefit from better defined categories of services (audit, audit related services, assurance services and non-audit services) and increased transparency in listed entity reports. This would mean the market could consider audit-related and other assurance services and fees separately from other non-audit services and fees. This would allow investors, shareholders and regulators to better evaluate the independence of the auditor.

Further, the United States, Canada and the UK require auditor fees to be broken down and disclosed in defined categories, such as audit fees, audit related fees, tax fees, and all other fees. In the United States, the nature of the services disclosed under each category is also required to be described.¹¹ There is also opportunity for audit committees of listed entities to be required to publish their non-audit services policies on their websites so that investors and other interested groups can review how the board is overseeing the independence of the auditor.

We also welcome debate about additional restrictions on non-audit services provided by auditors to the entities they audit to further mitigate perceptions of conflict. We recommend that such discussions be informed by existing international standard setting efforts by IESBA, which is currently developing standards that will introduce further restrictions on non-audit services and strengthen audit committee communications and approval processes. These standards are likely to be issued in the next 18-24 months and subsequently adopted in Australia.

11. Govregs, ITEM 9 of 17 CFR § 240.14a-101 -Schedule 14A. Information required in proxy statement, 2019, https://www.govregs.com/regulations/title17_chapterII_part240_section240.14a-101

6. Enhancing accountability through regulation

Terms of reference 5 seeks information on Australian and international reviews of auditing. In this section we discuss the lessons from the US Sarbanes Oxley reforms.

The impact of the introduction of the US Sarbanes Oxley Act 2002 (the SOX Act) provides useful lessons, and we support discussion on how similar regulatory frameworks could support enhanced accountability and greater transparency. We believe the SOX Act provides a balanced legislative framework within which government, regulators, auditors, company management and boards have to play their part in a broader financial reporting and business accountability ecosystem.

The PCAOB reports, “improved audit quality, along with improvements in auditor independence, corporate governance, internal controls, and financial reporting have resulted in a much stronger system aimed at protecting investors and the public interest.”¹²

The SOX Act has resulted in several positive changes and has contributed to enhanced audit quality and reliability of financial reporting.¹³ After the introduction of the SOX Act in 2002, restatements of financial reports peaked in 2006 and have reduced significantly since.¹⁴ The PCAOB reports that their oversight is driving significant improvement in quality, and has contributed to the robustness of the current financial ecosystem.¹⁵

Perceptions of SOX have also been positive, with a survey of certified financial advisors in 2017 finding that 82% thought that reliability of investment information has improved since its implementation.¹⁶ External audit of internal controls was perceived as helpful by 85% of CFOs, particularly in building trust with customers and stakeholders.¹⁷ These results suggest an improvement in market confidence.

Consequently, we welcome consideration of similar governance accountability reforms particularly for major capital market organisations (such as the ASX300), including:

- **Increased management accountability and liability:** measures that drive behavioural change in management teams, particularly in respect of internal controls and increased personal accountability and liability by management for financial reporting accuracy, and the internal control structure of the entity (as set out in sections 302 and 906 of SOX).
- **Enhanced auditor independence requirements and oversight by audit committees:** a variety of measures including audit committee pre-approval of non-audit services, detailed fee disclosure and reporting, and robust requirements for communication with audit committees. SOX also increased restrictions on the types of non-audit services that can be provided to audited entities.

12. Jeanette M. Franzel, “Update on PCAOB Efforts to Enhance Audit Quality,” presented at AICPA Conference on SEC and PCAOB Development, Washington, December 5, 2017.

13. John C. Coates, Suraj Srinivasan, “SOX after Ten Years: A Multi-disciplinary Review,” Harvard Law and Economics Discussion Paper No. 758 (2014): p. 36.

14. Derryck Coleman, “The Impact of SOX on Financial Restatements,” Audit Analytics, <https://blog.auditanalytics.com/the-impact-of-sox-on-financial-restatements/>, February 28, 2017.

15. Jeanette M. Franzel, “Update on PCAOB Efforts to Enhance Audit Quality,” presented at AICPA Conference on SEC and PCAOB Development, Washington, December 5, 2017.

16. Center for Audit Quality, CAQ Pulse Poll: Certified Financial Advisor Perspectives on the Sarbanes-Oxley Act, 2017, p.2.

17. Center for Audit Quality, CAQ Pulse Poll: Chief Financial Officer Perspectives on the Sarbanes-Oxley Act, 2017, p.2.

7. Our commitment to an effective regulator and regulatory regime

Terms of reference 8, 10 and 11 relate to the Australian regulatory regime for audit. In this section, we discuss the importance of a well resourced, independent and forward-looking regulator.

Deloitte is proud of its role supporting the capital markets and protecting investors and the public trust. We have this in common with ASIC.

We believe a capable, well-resourced, independent and forward-looking regulator is essential to underpin audit quality and maintain trust and confidence in the capital markets. ASIC is a critical player in the financial reporting ecosystem. ASIC notes within its submission to this Inquiry, "ASIC coverage of our regulated population through our inspection programs is substantial, and is more extensive than some comparable peer regulators, given our resourcing".¹⁸ We acknowledge this and are supportive of increased resourcing for ASIC.

We also support the announcement of ASIC's \$400 million in additional funding in the FY19-20 budget, as well as recent legislation that has removed the requirement for ASIC to employ under the Public Service Act (1999).¹⁹ We expect these measures will enable ASIC to continue to build its capacity and augment its capability to enable it to execute its functions effectively across monitoring, investigation and enforcement.

We value the ASIC inspection and financial reporting surveillance programs and benefit from the extensive dialogue we have with ASIC during, and as a result of, both processes. We believe that the inspection process serves an important role in improving audit quality, and we value the insights it brings to both entities and the audit profession.

Enduring audit quality requires an effective relationship between the auditor, the entities they audit, and the regulator. We have been constructively vocal in our views on how to enhance the inspection process, including the opportunity to move from a system that inspects a small number of files to one that tests the system of quality control. We have also encouraged that inspection findings be rated by severity, including being clear where restatements were required as a result of ASIC's review programs. We have had these discussions openly with ASIC and others. We continue to be supportive of ASIC's efforts to introduce a balanced scorecard measure of quality, of which we have always been proponents, and look forward to its introduction.

Both in Australia and globally, we value the regulator's role in shaping the audit of the future. ASIC, the Financial Reporting Council (FRC) and the International Forum of Independent Audit Regulators (IFIAR) all have a role to play in providing a platform for dialogue across audit and other regulators, engaging the profession, regulators and standard setters to keep pace with technology advances, promoting the key roles of all members of the financial reporting ecosystem, and articulating the necessity of consistent regulations, inspection regimes and standards across countries. We look forward to continuing to participate and constructively support this important dialogue.

18. Australian Securities and Investments Commission, Regulation of Auditing in Australia: Submission 16, p. 14.

19. Australian Government, Budget Overview, April 22, 2019, p.22, <https://www.budget.gov.au/2019-20/content/download/overview.pdf>; Treasury Laws Amendment (Enhancing ASIC's Capabilities) Act 2018.

Deloitte submission to the inquiry into the regulation of auditing in Australia

Conclusion

We welcome the opportunity for further discussion and participation in the Inquiry. We support change that enhances informed transparency and are ready to contribute to the work of the Committee.

