Response to the Interim and Final Reports (2020) of the Parliamentary Joint Committee on Corporations and Financial Services regarding the Regulation of Auditing in Australia.

It is my privilege to respond to the Interim and Final Reports (2020) of the Parliamentary Joint Committee on Corporations and Financial Services regarding the Regulation of Auditing in Australia. I am outlining my response to specific recommendations of Interim and Final Reports where I possess experience and expertise below:

Recommendation 3

4.145 The committee recommends that the Financial Reporting Council, in partnership with ASIC, by the end of the 2020–21 financial year, oversee consultation, development and introduction under Australian standards of:

- **defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and**
- **a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.**

Response: As an academic researcher, obtaining categorical disclosures of both audit and non-audit services from main auditors, related auditors, and other auditors, with a specific breakdown for controlled and group entities separately, is crucial for my research objectives. These detailed disclosures will enable a thorough investigation into the nature of audit and non-audit services, helping to pinpoint potential threats to auditor independence and audit quality. The specific breakdown of services for controlled and group entities is particularly valuable as it allows for a nuanced analysis of the relationships between these services and the independence of auditors and the quality of audits. This level of disclosure will not only facilitate academic research but also enhance transparency and accountability in the auditing process. This information is essential for understanding the associations between various services and their impact on both auditor independence and audit quality. By making these disclosures, auditors and their clients become more accountable to stakeholders, including policymakers and regulators. This increased transparency can contribute to the ongoing efforts to scrutinize and regulate audit practices, ensuring that they align with the highest standards of independence and quality.

In conclusion, the provision of categorical disclosures for audit and non-audit services, with a detailed breakdown for controlled and group entities, is instrumental in advancing academic research, promoting transparency, and fostering accountability in the field of auditing. I appreciate the significance of these disclosures in supporting a comprehensive analysis of the relationships between services and their implications for auditor independence and audit quality.

Recommendation 5

4.147 The committee recommends that the Accounting Professional and Ethical Standards Board consider revising the APES 110 Code of Ethics to include a safeguard that no audit partner can be incentivised, through remuneration advancement or any other means or practice, for selling non-audit services to an audited entity.

Response: I fully support the suggested recommendation, as it represents a critical measure for enhancing both transparency and independence within the auditing process. There are valid concerns voiced by regulators, policymakers, and various stakeholders regarding the potential negative impact of auditor-provided consulting services on both independence and the quality of audits. It's a matter of common sense that conducting an audit on one's own work undermines independence and compromises the assurance of audit quality.

Additionally, it is crucial that audit firms refrain from exerting pressure on their audit partners to boost revenue by promoting the cross-selling of consulting services. Such practices could create a situation where audit partners develop overly friendly relationships with clients, potentially leading to the manipulation of financial reporting.

Introducing financial incentives for audit partners selling non-audit services to the entities they audit introduces a notable risk of conflicts of interest. This arrangement may tempt auditors to prioritize the interests of the client, who also serves as a source of additional revenue, potentially compromising the necessary objective and independent assessment integral to the audit process.

Furthermore, incentivizing auditors to sell non-audit services could result in a shift of their focus away from the essential responsibilities of conducting a high-quality audit. If the primary motivation becomes generating revenue through additional services, there is a real risk that the time and attention dedicated to the audit process may be compromised, potentially impacting the thoroughness and accuracy of the audit.

Given that the public relies on audited financial statements for making informed decisions in investments and other financial matters, maintaining trust in the integrity of the audit profession is paramount. Any perception that auditors are influenced by financial incentives to sell additional services has the potential to erode this trust and compromise the overall credibility of financial reporting.

Recommendation 6

4.151 The committee recommends that the Financial Reporting Council, by the end of the 2020–21 financial year, oversee the revision and implementation of Australian standards to require audited entities to disclose auditor tenure in annual financial reports. Such disclosure should include both the length of tenure of the entity's external auditor, and of the lead audit partner.

Response: I completely agree with this recommendation, as there are concerns that an auditor's excessive familiarity with the client might compromise professional skepticism, leading to a reduced ability to identify and report irregularities. A lengthy relationship might create financial dependency on the client, affecting the auditor's willingness to raise concerns or challenge management decisions. Moreover, prolonged relationships might compromise independence, leading to lower audit quality and an increased risk of audit failure. In my capacity as an auditing researcher, access to information about auditor and partner engagement (date and year of commencement) disclosure will furnish me with the necessary data to scrutinize the correlations between auditor/partner tenure, auditor independence, and audit quality. This data holds significant importance as it can serve as crucial evidence for policymakers, regulators, and stakeholders, shaping discussions and decisions in the auditing domain.

Recommendation 9

5.67 The committee recommends that the Corporations Act 2001 be amended such that entities required to have their financial reports audited under the Act must establish and maintain an internal controls framework for financial reporting. In addition, such amendments should require that:

- **management evaluate and annually report on the effectiveness of the entity's internal control framework; and**
- **the external auditor report on management's assessment of the entity's internal control framework.**

Response: Internal control deficiency, auditor independence, and audit quality are interconnected aspects of the auditing process, each playing a crucial role in ensuring the reliability and accuracy of financial reporting. Weak internal controls within an organization heighten the risk of material misstatements in financial statements. Internal controls are mechanisms that help prevent, detect, and correct errors or fraud in financial reporting. When these controls are inadequate, the likelihood of inaccuracies or intentional misstatements increases. Moreover, weak internal controls pose a challenge for auditors in carrying out their responsibilities. The absence of robust internal controls makes it more difficult for auditors to identify and address errors or fraudulent activities during the audit process. Auditors must assess the effectiveness of internal controls as part of their audit procedures. When internal controls are weak, the risk of the auditor failing to detect material misstatements rises, impacting the overall quality of the audit.

Auditor independence is fundamental to the audit process as it ensures that auditors can provide an objective and impartial assessment of the financial statements. Audit quality is the overall effectiveness of the audit process in ensuring the reliability of financial reporting. A strong correlation exists between internal control deficiency, auditor independence, and audit quality, as the former directly impacts the auditor's ability to provide assurance on the accuracy and completeness of financial statements.

In the modern digital age, internal controls also play a vital role in safeguarding data security. Inadequate internal controls may expose the organization to risks related to unauthorized access, data manipulation, or other cybersecurity threats, further emphasizing the importance of robust controls for maintaining audit quality.

In summary, strong internal controls enhance audit quality by reducing the risk of material misstatements, allowing auditors to perform their duties effectively. Additionally, maintaining auditor independence is crucial for unbiased assessments, contributing to the overall quality and credibility of the audit process.

Should you require assistance with any other matters, please do not hesitate to contact me.

Your sincerely

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