APESB

27 November 2019

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600
By email: corporations.joint@aph.gov.au

Dear Committee Secretary,

RE: Clarification of comments at Public Hearing for the Inquiry into the regulation of Auditing in Australia held on 19 November 2019

APESB has reviewed the Committee's Hansard document relating to the public hearing on 19 November 2019 of the Parliamentary Joint Committee on Corporations and Financial Services (PJC) in relation to your inquiry into the regulation of auditing in Australia.

We have noted several matters in the transcript that relate to the APESB and its pronouncements, which we believe require further clarification for the PJC to develop a comprehensive understanding of the existing auditor independence requirements in Australia.

We respectfully encourage the PJC to review APESB's **Submission 42** and IESBA/IAASB's **Submission 18** to obtain a complete understanding of Auditor Independence requirements that exist locally and globally.

These are the standard setters submissions that deal with the existing ethics and auditor independence standards. APESB is the custodian of the ethics and auditor independence standards in Australia, and globally it is IESBA.

1. The APESB's Code of Ethics is mandatory for auditors and audit firms in respect of Corporations Act Audits

Legislative instrument ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements* (originally operative from 1 January 2010) provides legislative backing for the APESB's Code of Ethics, which incorporates auditor independence requirements.

Accordingly, the Code of Ethics has the force of law for audits and reviews performed of entities subject to the *Corporations Act 2001* and is a mandatory requirement (refer to footnote 1 on page 2 of APESB **Submission 42**). Additionally, it is mandatory for members of the three accounting bodies (CA ANZ, CPA Australia and IPA) to comply with APESB's Code of Ethics. We do acknowledge that the Code having the force of law via the auditing standards was noted once during the hearing (refer Hansard page 20, lines 43-47).

Accordingly, it should not be characterised as guidance with respect to audits and reviews of entities subject to the *Corporations Act 2001*.

Please refer to Hansard page 13, lines 15 and 43; page 21, line 28; and page 33, line 28.

Evidence: s307A and s336 of the Corporations Act 2001 and ASA 102 Compliance with Ethical Requirements when Performing Audits, Review and Other Assurance Engagements

2. The threats and safeguard approach of the Code of Ethics has been strengthened with the "enhanced conceptual framework."

We acknowledge that the Code of Ethics incorporated a principles-based threats and safeguards approach for a considerable period. However, the Code of Ethics and auditor independence requirements have recently undergone a major rewrite and restructure, which is probably the most substantive revision that has occurred in the last two decades. The Code of Ethics was reissued globally by IESBA in April 2018.

As noted in IESBA/IAASB's **Submission 18** to the inquiry, these changes were driven in large part by global regulatory concerns about the need for consistent application of the Code and to facilitate greater enforceability by the regulators.

APESB issued a restructured Code of Ethics to align with these global changes in November 2018, with the new Code becoming effective on 1 January 2020. The revisions include an "enhanced conceptual framework" that moves away from the "mindset" that an accountant can always develop a safeguard for a threat and explicitly recognises that, in some instances, there will be no safeguards. These changes are explained further on page 16 of APESB's **Submission 42**. The practical implication will be further restricting services that can be provided by a firm to an audit client.

Accordingly, given that global firms that belong to the Forum of Firms would have adopted the new Code of Ethics from July 2019, and that these revisions become effective in Australia from 1 January 2020 (with early adoption permitted), the application of the previous "threats and safeguards" approach will be strengthened from 31 December 2019 with the "enhanced conceptual framework" which explicitly recognises that in certain instances there will be no safeguards and the only option available is to decline or end the specific professional activity.

Please refer to Hansard page 19, lines 48-50; page 20, lines 12-16; page 21, line 28; page 33, lines 27-28; and page 36, line 44.

Evidence: IESBA *Basis for Conclusions: Revisions Pertaining to Safeguards in the Code* (April 2018), pages 5 to 13, which discusses the new enhanced conceptual framework.

3. APESB's Code of Ethics incorporates multiple prohibitions other than Bookkeeping

APES 110 sets out many prohibitions concerning services and activities that cannot be provided to an audit client that is a Public Interest Entity, which are continuously being reviewed for best practice globally. The prohibitions are far more extensive than just prohibiting bookkeeping services.

The APESB directly prohibits certain services and activities outright, prohibits others if they have a material impact on the financial statements, and has a list of other services, interests, and relationships that need to be assessed to determine whether they are permissible services and activities.

APESB is of the view that the prohibitions that apply depending on whether the service has a material impact on the financial statements of the Public Interest Entity, in effect, prohibits the ability to perform the vast majority of services that impact the financial statements unless it is immaterial and clearly inconsequential.

The Code has specific prohibitions supported by the application of the enhanced conceptual framework. This principles-based approach allows for consideration of new services and technological advances, which may result new activities that might make sense for an auditor to do if it utilises the information that is already subject to audit.

Additionally, the APESB's Code and AUASB's ASA 610 effectively prohibits an audit client's internal audit team from providing direct assistance on an external audit. Assisting in this manner is a practice that is allowed in the US but prohibited in Australia to enhance the auditor's independence.

Further details on the prohibitions are set out in APESB's **Submission 42** in Section 4 of Appendix B (pages 25-27), in the IESBA's high-level summary of prohibitions in the IESBA Code or the APESB's Summary of prohibitions in the Australian Code (APES 110).

Accordingly, we do not believe that it is appropriate to form a view that, in comparison to the US system, the only service that is effectively prohibited in Australia is bookkeeping services. Please refer to Hansard page 20, lines 11-12; and page 21, lines 20-21 and 27-28.

Evidence:

The following documents attached to this letter provide evidence of the prohibitions in the APESB's Code and IESBA's Global Code which is used for transnational audits:

- APESB's Summary of prohibitions in APES 110 (2019)
- IESBA's Summary of prohibitions in the IESBA Code (2019)
- IESBA's Code high-level summary of prohibitions (2012) which are also incorporated in the extant Australian Code in addition to the AUST provisions.

4. The Engagement Partner Cooling-off period has increased to 3 years – effective 1 January 2019

Effective from 1 January 2019, all audit engagement partners and audit partners who perform an engagement quality review are required under the Code of Ethics to cool-off for a minimum of three years. While the *Corporations Act 2001* specifies a cooling-off period of two years, as the Code of Ethics (which has legislative backing from ASA 102) specifies a 3-year cooling-off period, in practice from 1 January 2019 the effective minimum cooling-off period is 3 years and for periods beginning on or after 1 January 2024 the cooling-off period will increase to 5 years for Engagement Partners.

Refer to pages 21-22 of APESB's **Submission 42** for further details on how the requirements in the Code of Ethics and the *Corporations Act 2001* interact and impact on the required minimum cooling-off period for audit partners.

We believe that the information stated above needs to be taken into account in fully understanding the existing audit partner rotation requirements in Australia. Please refer to Hansard page 28, line 36, and page 33, line 16.

Evidence: pages 21-22 of APESB's **Submission 42**, in particular Tables 2 and 3, and Audit Partner Rotation requirements in Australia Technical Staff Q & A.

5. Prohibition on an Audit Partner being remunerated based on their ability to cross-sell other services

We note that the above issue was raised during the hearing and we would like to bring to the Committee's attention that since July 2011 there has been prohibition in APESB's Code of Ethics (which has legislative backing via ASA 102) that an audit partner shall not be compensated or evaluated based on that partner's success in selling non-assurance services to an audit client. Please refer to Hansard page 32, lines 32-34.

Evidence: Page 20 of APESB's **Submission 42**, APES 110 Code of Ethics for Professional Accountants (2010), paragraph 290.229 – effective from 1 July 2011 and restructured APES 110 Code of Ethics for Professional Accountants (including Independence Standards) (2018), paragraph R411.4 – effective from 1 January 2020 with early adoption permitted.

Concluding comments

We believe that the PJC will need to have a complete understanding of the existing auditor independence requirements in Australia to develop an informed policy position with respect to the future framework of Audit regulation in Australia.

As stated above, we strongly encourage the PJC to review **Submissions 18** and **42** to your inquiry to gain a comprehensive understanding of the global and Australian auditor independence requirements, which have recently undergone substantial revisions with the issue of the restructured Code (effective globally from 1 July 2019 and in Australia from 1 January 2020).

Please note that APESB's submissions are public documents and we request that this submission be shared publicly on your website. APESB will be publishing a copy of this submission on our website in due course.

If you wish to discuss further or should you require any additional information, please contact [redacted], at [redacted]

Yours sincerely

[redacted]

Nancy Milne OAM

Chairman

CC: Dr. Stavros Thomadakis, Chairman, IESBA

APES 110 – Prohibited Non-assurance Services, Interests and Relationships for Auditors of Public Interest Entities – November 2019

APESB
Accounting Professional & Ethical Standards Board

APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (APES 110) requires audit firms to be independent when undertaking audits, reviews and other assurance engagements. In addition, there are specific prohibitions when the entity is a Public Interest Entity[1] (PIE).

APES 110 sets out a conceptual framework for auditors to assess whether non-assurance services, interests or relationships create threats to the auditor's independence. The application of the conceptual framework involves a rigorous analysis of the service, interest, or relationship to identify, evaluate, and address threats to independence and involves a reasonable and informed third party test. If the service, relationship or interest creates a threat that cannot be eliminated and if safeguards are not available to reduce the threat to an acceptable level, the firm is required to decline or end the service or audit engagement.

The independence assessment must also consider the aggregate impact of multiple threats to independence, including where the fees in respect of multiple audit clients referred represent a large proportion of total fees for the firm.

Audit engagement teams in Australia, specifically excludes individuals within the client's internal audit function as direct assistance by the internal audit function of the entity to the external auditor is prohibited in Australia.

APES 110 also recognises that some situations create threats that cannot be reduced to an acceptable level and are, therefore, specifically prohibited. These **prohibitions** relate to certain non-assurance services, interests, and relationships for auditors of PIEs and are either outright prohibitions or prohibitions based on the materiality to the financial statements of the PIE being audited. In assessing materiality, auditors must consider both qualitative and quantitative aspects. These prohibitions have legal enforceability in respect of Corporations Act Audits and reviews due to Auditing Standard ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*.

The following tables provide a high-level summary of APES 110 prohibitions. Please note that this summary does not amend or override the Code, the text of which alone is authoritative. Reading this summary is not a substitute for reading the Code.

Strictly Prohibited Non-Assurance Services	Prohibited Non-Assurance Services (based on materiality)
Assuming management responsibility for a client	Valuation services
Accounting and bookkeeping services, including preparing accounting records or financial statements[2]	Calculating current and deferred tax liabilities (or assets)
Serving as General Counsel	Tax planning or other tax advisory services where its effectiveness requires a particular accounting treatment or presentation in the financial statements, and there are reasonable doubts as to the appropriateness
Performing negotiations for a client as part of a recruiting service	Acting as an advocate for a client in the resolution of tax disputes before a public tribunal or court
Recruiting services for a position at the client as director or officer, or for a senior management position that can exert significant influence over accounting records or the financial statements	Internal audit services on a significant part of internal controls over financial reporting, financial accounting systems or amounts/disclosures in the financial statements
Promoting, dealing in or underwriting a client's shares	Designing or implementing IT system services that are a significant part of internal controls over financial reporting or that generate information significant to accounting records or financial statements
Compensating or evaluating a key audit partner based on that partner's success in selling non-assurance services	Advocacy role in resolving a dispute or litigation
Serving as a Company Secretary	Litigation support services involving estimating damages or other amounts that affect the financial statements
Managing the administration of an insolvent entity	Corporate finance services where its effectiveness requires a particular accounting treatment or presentation in the financial statements, and there are reasonable doubts as to its appropriateness

[1] Public Interest Entities (PIEs), as defined in APES 110 in the Glossary and paragraphs 400.8 to AUST 400.8.1 A1.
[2] A Firm or Network Firm can provide rou ine or mechanical services in limited circumstances for divisions or related entities of the audit client if the personnel providing the service are not part of the audit team and the divisions or related entities are immaterial to the financial statements being audited, or the services relate to matters that are immaterial.

Prohibited Interests, Relationships and Actions (including materiality factors where noted)	
Acting where a conflict of interest compromises professional or business judgement	Business relationships involving holding common interests in a closely held entity with a client if the business relationship is significant, any financial interest is material or the financial interest does not create control over the closely-held entity
Contingent fees for an audit engagement or for a non-assurance service to the audit client where the fees are material to the firm (or network firm) or the outcome of the service is dependent on a judgement related to the material amount in the financial statements	Participating in an audit team if an immediate family member is, or was during the engagement period, a director or officer of the client or is able to exert significant influence over accounting records or financial statements of the client
Commissions or similar benefits for assurance services	Participating in an audit team if, during the period covered by the audit report, an individual served as a director or officer of the audit client or was an employee able to exert significant influence over the accounting records or financial statements
Direct financial interest or material indirect financial interest in the client	Partners or employees acting as a director or an officer of the client. A firm **must** refuse/withdraw from an audit if a partner or employee served as an officer (including an administrator) of the client or as an employee able to exert direct and significant influence over the subject matter of an audit
Direct financial interest or material indirect financial interest in the client's parent entity when the client is material to that entity	Significant connections by a firm with a former partner or audit team member who is now employed by an audit client
Common financial interests in an entity with a client where either of the financial interests is material and the client has significant influence over the entity	Audit engagements for a client within defined periods where key audit partners and senior or managing partners have joined the client as director, officer or an employee able to exert significant influence over accounting records or financial statements
Loans or guarantees for a loan to the client that are material	Loan of personnel to the client unless specific requirements are met
Loans or guarantees for a loan from a client that is a bank or similar institution that are not made under normal lending procedures, terms and conditions	Long association with the client, including serving as an Engagement Partner, Engagement Quality Control Reviewer or other key audit partner and subject to specified cooling-off periods[3]
Deposits or brokerage accounts with a client that is a bank, broker or similar institution unless under normal commercial terms	Audit partners on a cooling-off period due to long association are prohibited from: • Being on the audit engagement team; • Providing quality control; • Consulting with the client or engagement team on technical or industry-specific issues, transactions or events affecting the audit engagement; • Leading or coordinating the professional services provided to that client; • Overseeing the relationship with the client; or • Undertaking any other role or activity involving frequent interaction with senior management or those charged with governance of the client, or direct influence on the outcome of the audit engagement
Material loans or guarantees for a loan from a client that is not a bank or similar institution	Gifts and hospitality from the client that are other than trivial and inconsequential
Close business relationships with a client that are significant or involve a material financial interest	Offering or encouraging others to offer inducements or accepting or encouraging others to accept inducements, that the auditor considers is made with the intent to improperly influence the behaviour of the recipient or another individual

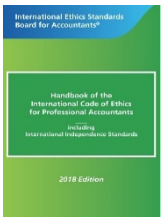
[3] Refer to the APESB Technical Staff publication *Audit Partner rotation requirements in Australia Technical Staff Questions & Answers* for further details of these prohibitions.

IESBA International Ethics Standards Board for Accountants®

529 Fifth Avenue, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.ethicsboard.org

Summary of Prohibitions Applicable to Audits of Public Interest Entities[1]

November 2019



The *International Code of Ethics for Professional Accountants, (including International Independence Standards)* (the Code) contains prohibitions that apply when a firm audits a public interest entity. If a service, interest, or relationship is not covered by one of the prohibitions below, the firm is required to apply the conceptual framework to comply with the International Independence Standards. The application of the conceptual framework involves a rigorous analysis of the service, interest, or relationship to identify, evaluate and address threats to independence, and involves a reasonable and informed third party test. If the service, relationship or interest creates a threat that cannot be eliminated and if safeguards are not available to reduce the threat to an acceptable level, the firm is required to decline or end the service or audit engagement.

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Prohibited Non-Assurance Services

Prohibited Without Regard to Materiality

- Assuming a management responsibility
- Serving as General Counsel
- Accounting and bookkeeping services, including preparing accounting records and financial statements[2]
- Promoting, dealing in, or underwriting client shares.
- Negotiating for the client as part of a recruiting service.
- Recruiting directors/officers, or senior management who will have significant influence over accounting records or financial statements
- Evaluating or compensating a key audit partner based on that partner's success in selling non-assurance services to the partner's audit client

Prohibited if Material to the Financial Statements

- Valuation services
- Calculations of current/deferred taxes
- Tax or corporate finance advice that depends on a particular accounting treatment/financial statement presentation with respect to which there is reasonable doubt as to its appropriateness
- Acting as an advocate before a public tribunal or court to resolve a tax matter
- Internal audit services relating to internal controls over financial reporting, financial accounting systems, or financial statement amounts/disclosures
- Designing/implementing financial reporting IT systems

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[1] This is high-level summary is not a substitute for reading the Code, which provides details on the application of these prohibitions. The IESBA eCode provides a complete list of the explicit prohibitions in the Code.

[2] Can only be provided to divisions/related entities if routine/mechanical, if specified conditions are met.

- Estimating damages or other amounts as part of litigation support services
- Acting as an advocate to resolve a dispute or litigation

Prohibited Interests, Relationships and Actions

- Contingent fees for an audit engagement or, when material to the firm, for a non-assurance service to the audit client
- Financial interests in the client
- Financial interests in an entity in which the client has a material interest, and can significantly influence
- Financial interests in the parent entity if the client is material to that entity
- Loans from a client lending institution that have not been made under normal lending procedures, terms, and conditions, or from a client that is not a lending institution and that are material
- Material loans to a client
- Deposits with a client not held under normal terms
- Close business relationships with a client that are significant or entail a material financial interest
- An individual being on the audit team if, during the period covered by the audit, the person was a client director/officer, or an employee able to significantly influence the accounting records or financial statements
- Audit team members whose immediate family member is a client director/officer, or an employee able to significantly influence the accounting records or financial statements
- Former audit team members or a partner joining the client if significant connections with the firm remain
- A key audit partner or senior/managing partner joining a client before a defined period of time
- Partners/employees serving as a client director or officer
- Personnel loans to a client except under predefined circumstances
- A key audit partner serving for more than 7 years
- For a key audit partner serving a cooling-off period, being on or providing quality control for the audit engagement; consulting with the engagement team or the client regarding technical or industry-specific matters affecting the audit engagement; leading/coordinating professional services provided to the audit client, or overseeing the firm's or a network firm's relationship with the audit client; or undertaking any other role or activity involving significant or frequent interaction with senior management or those charged with governance of the client, or direct influence on the outcome of the audit engagement
- Allowing a conflict of interest to compromise professional or business judgment
- Offering, or encouraging others to offer, any inducement made with intent to improperly influence the behavior of the recipient or of another individual
- Accepting, or encouraging others to accept, any inducement that the auditor concludes is made with intent to improperly influence the behavior of the recipient or of another individual
- Accepting gifts and hospitality from the client that are other than trivial and inconsequential

IESBA Code of Ethics Prohibitions Applicable to Audits of Public Interest Entities

The Code of Ethics for Professional Accountants (the Code) issued by the International Ethics Standards Board for Accountants in July 2009 contains the prohibitions summarized below that apply to the audits of public interest entities. In addition to complying with these prohibitions, professional accountants are required to apply the *conceptual framework* set out in the Code to evaluate a service, interest, or relationship that is not prohibited by the Code. This includes situations where the Code does not specifically address the service, interest, or relationship.

The conceptual framework entails (a) identifying threats to independence, (b) evaluating the significance of the threats, and (c) applying safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level. The requirement to apply the conceptual framework helps to ensure that a service, interest, or relationship is not automatically deemed to be permitted simply because it is not prohibited by the Code.

Summary of Prohibitions

Prohibited Non-Assurance Services

Prohibited Without Regard to Materiality

- Assuming a management responsibility.
- Serving as General Counsel.
- Accounting services
- Bookkeeping services
- Payroll services
- Preparing the financial statements and related financial information.
- Promoting, dealing in, or underwriting client shares.
- Negotiating for the client.
- Recruiting directors/officers, or senior management who will have significant influence over accounting records or financial statements.
- Evaluating or compensating a key audit partner based on that partner's success in selling non-assurance services to the partner's audit client.

Prohibited if material to the financial statements

- Valuation services
- Calculations of current/deferred taxes.
- Tax or corporate finance advice that depends on a particular accounting treatment/financial statement presentation with respect to which there is reasonable doubt as to its appropriateness.
- Acting as an advocate before a public tribunal or court to resolve a tax matter.
- Internal audit services relating to internal controls over financial reporting, financial accounting systems, or financial statement amounts/disclosures.
- Designing/implementing financial reporting IT systems.
- Estimating damages or other amounts as part of litigation support services.
- Acting as an advocate to resolve a dispute.

Prohibited Interests and Relationships

- Financial interests in the client.
- Financial interests in an entity in which the client has a material interest, and can significantly influence.
- Loans from a client lending institution that have not been made under normal lending procedures, terms, and conditions, or from a client that is not a lending institution and that are material.
- Material loans to a client.
- Deposits with a client not held under normal terms.
- Close business relationships with a client that are significant or entail a material financial interest.
- Audit team members whose immediate family member is a client director/officer, or an employee able to significantly influence the accounting records or financial statements.
- Former audit team members or a partner joining the client if significant connections with the firm remain.
- A key audit partner or senior/managing partner joining a client before a defined period of time.
- A key audit partner serving for more than 7 years.
- An individual being on the audit team if, during the period covered by the audit, the person was a client director/officer, or an employee able to significantly influence the accounting records or financial statements.
- Partners/employees serving as a client director or officer.
- Contingent fees for an audit or assurance engagement or, when material to the firm, for a non-assurance service to the audit client.
- Accepting gifts or hospitality from the client that are other than trivial and inconsequential.