

20 December 2023

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

AUSTRALIAN SHAREHOLDERS' ASSOCIATION RESPONSE TO QUESTIONS ON NOTICE – ETHICS AND PROFESSIONAL ACCOUNTABILITY: STRUCTURAL CHALLENGES IN THE AUDIT, ASSURANCE AND CONSULTANCY INDUSTRY

Dear Dr Turner (Sean)

Please convey our thanks to Senator Deborah O'Neill for the opportunity to appear at the hearing of the Parliamentary Joint Committee on Corporations and Financial Services on this topic on 6 October 2023, and the questions on notice.

Please see our response below:

QoN 1. In your submission, you suggested that the government legislate to make digital financial reporting standard practice in Australia. In its 2020 Interim report on Auditing, this committee also recommended that the Australian Government take appropriate action to make digital financial reporting standard practice in Australia. What are the benefits of and barriers to making digital financial reporting standard practice in Australia?

Benefits of Digital Financial Reporting

- 1. Increased Efficiency:** Automating financial reporting processes can significantly enhance efficiency. For instance, a study by the American Institute of CPAs found that automation in financial reporting helps reduce errors and speeds up the reporting process. XBRL (eXtensible Business Reporting Language) and Inline XBRL (iXBRL, where the data is imbedded in reports rather than being added as attachments) is mandated in a number of jurisdictions, which facilitates cross-border operations and comparisons.
- 2. Improved Data Quality and Accuracy:** Digital systems enhance data reliability through real-time processing and validation checks, as evidenced by the experiences of companies in the EU after the implementation of the iXBRL format. By embedding XBRL data directly into HTML files, iXBRL reduces the likelihood of inconsistencies between the human-readable and machine-readable versions of financial statements.
- 3. Enhanced Transparency and Accountability:** Digital reporting allows for more consistent and accessible disclosures, improving stakeholder trust and engagement. With iXBRL, the XBRL data is embedded directly into a company's HTML filing to the SEC, making the information both human-readable and machine-readable without the need for separate XBRL filings. This change has been aimed at making financial disclosures more accessible and easier to analyse for investors, analysts, and the broader public.

4. **Improved Compliance:** Digital reporting aligns with regulatory trends towards digital formats. The SEC's mandate for iXBRL in financial reporting was [mandated in June 2018](#) to commence with largest accelerated filers in 2019 and rolling out to other accelerated filers in 2020 and all listed companies for years ending after 15 June 2021. From June 2016, it had been optional and iXBRL replaced XBRL, which had been required from 2009.
5. **Cost Reduction:** Over time, as seen in Japan's adoption of XBRL, digital reporting reduces costs related to physical storage and manual data processing.
6. **Facilitation of Data Analysis:** Leveraging advanced analytics becomes easier with digital data. The Financial Times reported on how AI and analytics have transformed financial analysis in markets with digital reporting standards.

Barriers to Adoption in Australia

1. **Implementation Costs:** The initial costs can be high, as observed in the UK following the mandate for digital tax reporting.
2. **Technical Challenges:** The transition requires significant technical expertise. In the EU, small firms struggled with the technical demands of iXBRL implementation.
3. **Resistance to Change:** This is a universal challenge, as noted in a [Harvard Business Review](#) article on organisational change.
4. **Data Security and Privacy Concerns:** Cybersecurity risks are a global concern in digital transitions, as reported by the World Economic Forum.
5. **Regulatory and Standardisation Issues:** Varying standards and regulations, as seen in the initial stages of XBRL adoption in different countries, can complicate the transition.
6. **Digital Divide:** A disparity in digital capabilities between larger and smaller firms was evident in the EU post-iXBRL adoption.

International Experiences

- **United States:** The adoption of XBRL for SEC reporting has improved the speed and accuracy of financial data processing from 2009.
- **European Union:** The implementation of iXBRL has been challenging but ultimately led to more streamlined and transparent financial reporting. (Similar to US XBRL adopted in 2008, iXBRL 2020.)
- **Japan:** Early adoption of XBRL in 2004 demonstrated long-term cost savings and efficiency gains, despite initial hurdles.

Conclusion

The transition to digital financial reporting in Australia, mirroring international experiences, offers significant benefits in efficiency and transparency but is not without its challenges, including costs, technical demands, and security concerns. Learning from the experiences of markets like the U.S., EU, and Japan could provide valuable insights for a smoother transition in Australia, as should the development of accounting software.

The implementation of inline digital reporting should be staged, where the larger listed companies adopt initially, followed by smaller listed companies and ultimately unlisted entities. We expect services and apps to develop on the back of the larger Australian listed companies producing digital reports, which will reduce the cost of adoption for the smaller entities overtime. Since 2015 ASIC has allowed voluntary digital reporting but apparently there has been none.

QoN 2. Thank you for your recommendations and suggestions on auditing and consulting. Would you please comment on related recommendations and suggestions in other written submissions to this inquiry? (See Submissions 1, 3, 10, 13, 25, 28, 30, 32, 33, 38, 48, 49, and 52.)

1 Graeme Samuel

Mr Samuel outlined views concerning the audit, assurance and consulting sectors similar to those of the ASA. We agree that large professional consulting firms are engaged to undertake responsibilities that entities feel inadequate to undertake themselves. In part this arises from the culture of “doing more with less” within an entity (there is no capacity for projects that are not “business as usual,”) as well as the benefits of outsiders/independent experts pulling together such a project in a short period of time.

As with all systems there are pros and cons of using external consultants in this way – often they walk in and shake up the business and are long gone when the consequences of the loss of corporate knowledge which becomes apparent over the coming years. The way to counter this is to be aware of the costs and retain sufficient internal resources to evaluate the plans and ensure they are fit for the longer term.

We agree there is an inherent conflict between the same firm undertaking advisory work and audit responsibilities for the same client, reducing independence through effectively marking their own homework and reducing the primacy of the audit where the financial reward is greater for advisory work than audit.

And though the publicising of the PwC failures we have learned there can be an inherent culture of major consulting firms in carrying out their professional responsibilities, via the downplaying of the importance of the audit partners in the oversight of these firms that lends itself to poor behaviours.

Samuel finishes saying he does not consider mandating a structural separation of the audit and consultancy divisions of the major accounting firms is either warranted or effective, but activity oversight, transparency and resultant accountability can be effective in imposing disciplines on firms that ultimately mandate a cultural reset – and that the actions of this Committee are a testament to that.

We concur.

We see bad actors in all forms of governance structures as well as good and we agree activity oversight and transparency results in accountability. ASA says all market participants have a role to play – we can’t defer to the consultants as smart and untouchable – and the structures need to support best behaviours.

We also note Samuel references ethical walls as being ineffective. Appropriately policed ethical walls can be effective but we prefer a prohibition on a firm (and its associates) from providing remunerated services to the same corporation (and its associates) which the firm is auditing – we consider that can be achieved by defining the list of services which an auditor can provide.

3 Prof Peter Wells

In brief, Prof Wells considers the transparency of provision of consulting services, particularly to Government, is the most efficient way to address conflicts and abuse of insider knowledge. Companies disclose the name of their auditor in their reports and reporting, and listed companies will often disclose the name of their advisory firms undertaking various projects. Typically, we would expect potential conflicts to be discussed with clients when a project is being considered - we agree that transparency will allow clients to assess those conflicts for themselves.

10 Institute of Internal Auditors

We agree with the statement “while there was unquestionably unethical (and at times illegal) behaviour, that this behaviour could continue undetected and unreported for so long, points to inadequate structural measures to identify and manage such risks, both within government and the services firms themselves.”

We agree a robust third line of defence, being the internal audit function and internal auditors, is an effective structural measure. We see the need to ensuring the staffing of the internal audit function includes appropriately qualified individuals and members of a professional association that can support the individuals and hold them to account.

The suggestion of introducing independent five-year External Quality Assessments of internal audit functions, is a reminder to us that periodic reviews of the effectiveness of governance should be undertaken. Rather than failures triggering such a review, a suggestion such as this should flag behavioural drift – though we have seen recommendations of various such reviews and reports being received and then ignored until a failure crystallises a response.

13 Dr Kelli Larson, Curtin Law School, Curtin University

Dr Larson points to the lack of transparency of the Professional firms as a significant issue and we agree with her suggestion that “One way to effect change for the big four consultancies that operate as partnerships is to mandate stronger, transparent and mandatory governance practices to be applicable to partnership structures and ensure enforcement sanctions have real consequences.”

She also comments on the moving of consultants between roles as consultants and working for the government – and the use of cooling off periods to reduce conflicts and poor behaviour. Governance within the public sector is outside ASA’s daily activities and experience, but we note preventing “regulatory capture” by larger companies in regulated industries is often dealt with by cooling off periods, which, if observed, slows the capture. Sequential cooling off periods would slow switching between Government and consulting roles repeatedly.

25 KPMG

A comprehensive detailed submission – the recommendations, from our knowledge, appear sound. We also note the reference to actions in international jurisdictions on audit and supervising audit and confirm the Australian experience with professional firms and loss of trust is not unique to our jurisdiction. Maintaining confidence in the audit is a global challenge, which is being addressed by governance structures and oversight and better conveying of the nature of audit as the expectations gap (audit expected to catch all misstatement and prevent insolvency at all times – as opposed to all participants having a part to play and sometimes companies will fail) continues to exist.

Items of interest for ASA:

On page 8 we note the suggestion that specialists will be more rounded/better (our wording) with ability to work on other projects: “For our ASX300 audit clients, specialists represent around 15-20 percent of time spent on the audit. This percentage is expected to increase with the government’s introduction of mandatory climate related financial disclosures.” ASA is comfortable with auditors providing assurance on sustainability disclosures where it is an area of expertise they foster - but express a note of caution on separating revenue generating consulting on development of sustainability strategy and implementation. Also, the nature of other roles which use the balance of the specialist’s time and timing should be reviewed periodically to ensure best governance settings and outcomes. Further on p8, we consider the introduction of AI into audit – finding a better way to achieve the purpose of the audit – is similar to the imperative on company boards to ensure the information they receive is fit for purpose – and is what is expected in the role. The

effectiveness of the audit needs to be periodically assessed, and all the market participants need to engage and flag any deterioration in audit quality.

28 Tax Justice Network et al

The recommendation that “auditing and consultancy firms be unable to make political donations. Further, any auditing or consulting firm that has made a political donation in the last year should not be able to obtain a Commonwealth Government contract” is in keeping with ASA’s guideline for large-listed companies that they do not make political donations. Shareholders find the idea that donations are able to influence the regulatory settings almost as offensive as directors and executives supporting political campaign of personal rather than corporate interest.

In relation to the recommendation that “rules governing Big 4 auditing of corporations, the Committee should recommend a ban on the same firm providing auditing and tax services. Additionally, as a standard practice of good governance, corporations should be required to change audit firms regularly.” We consider most tax services should be included in prohibited non-audit services. We consider audit forms should be changed periodically with persisting past 10 years requiring an if not why not explanation, and expectation that within 20 years the firms are changed.

32 & 33 Guthrie J., Dumay, J. Twyford, E. and Hazelton, J.

We were asked to comment on the references to CBA and Macquarie Group’s audit. We consider the difference in costs to be expected. CBA is a domestic big four bank with a greater proportion of its business tied to validated systems which are simpler to interrogate. Macquarie Group is a more diverse multinational business and some of its operations are highly specialised and potentially unique or at the very least in the early stage of industry development – and requiring bespoke audit techniques.

We note [s300 11B](#) of the Corporations Act requires the information that is said to be difficult to find, being the non-audit services payment to the auditor. The section also requires the page reference to financial accounts’ disclosure of non-audit payments to the auditor to be included in the Directors’ Report. We support a greater level of transparency in these payments by breaking down the nature of other services provided by auditor (taxation related, assurance), as required in other jurisdictions. We also support a list of prohibited non-audit services that may not be provided by the auditor.

38 BDO

BDO’s submission raises the complexity of the audit as requiring access to individual with expertise outside of auditing. ASA sees some risk of audit-only individuals being sidelined from broader company concerns – with a risk that misbehaviour will slip into these cracks. In keeping with our assertion that all participants have a role to play in maintaining confidence in the operation of financial markets, auditors will need to be able to flag audit adjacent matters.

We agree with the suggestions below:

BDO believes a set of ethical standards that govern the conduct of individuals who are not professional accountants is needed. The standards must address the shortcomings of the current code by extending beyond the professional accountant to include all professionals who provide consulting services.

Standards should include clear guidance and minimum standards of continuing professional development, with training requirements embedded in the standards to address the principles of integrity, objectivity, confidentiality, and competency.

BDO suggests the establishment of an independent oversight body for Professions.

48 CPSU

This submission proposes a number of public sector specific recommendations which are outside of ASA's expertise/area of interest which is promoting fair outcomes for retail shareholders in exchange traded assets and super.

CPSU suggests structural separation of audit and consulting services, we consider gains in trust around audit can be achieved by defining a list of prohibited non-audit services that cannot be undertaken by a company auditor.

Other comments:

- Entities need to build or retain internal capacity to oversight consulting projects and engagement or develop an external structure to provide the skills to oversight and report.
- ASA supports a fair taxation regime for individuals and companies, and we expect companies not to avoid tax obligations. We publicly query companies who are resident in tax havens.
- Entities should ensure consultants and subcontractors adhere to company policies, ethics and standards.

49 ASIC

ASIC's submission confirms partnership structures slip through reporting and accountability structures that apply to companies. ASA considers that when partnerships were smaller the risk was not concentrated. The submission states: Auditors and audit firms that conduct audits under the Corporations Act of 10 or more listed entities are required lodge a transparency report with ASIC. The transparency report includes information about the Firm's audit operations and related quality management systems. It does not include information about a Firm's other non-audit operations and services provided to non-audit clients (such as consultancy services or tax). ASA considers there is a risk that partnership consultancy revenue can be sizable and therefore could impact audit independence. ASA considers revenues and its details should also be reported.

In relation to ASIC's change of practice on audit review, we found the lack of detail to be a shortcoming of previous model. There was no gradation of the natures of failings, the percentage announced could represent minor or major (material or immaterial) failings. ASA considers a risk-based approach to be a sensible modernisation – subject to assessment of its effectiveness over the coming 12 to 24 months.

52 Professor Allan Fels AO

Prof. Fels is supportive of preventing audit firms from also operating in the field of consultancy, quoting the recent requirements in the UK for separation. Given the failure of EY's breakup, ASA considers while it may be ideal it is not going to be quick - we suggest the defining of non-audit activities which audit firms can't provide will be quicker and more effective to implement.

QoN 3. On pages 22–24 of Submission 50, Treasury set out principles for evaluating whether to intervene in the regulation of the audit, accounting and consulting industry. Would you please discuss how the Treasury principles might be applied to your recommendations or suggestions?

Firstly, we thank Treasury for distilling the background information on this area of the economy and market which is keeping with our understanding.

ASA agrees that applying a risk-based approach to identifying potential regulatory gaps is sensible and that consequences can be a lack of trust, lack of integrity in the market and failure of an entity with potential of contagion to other entities. Likelihood of failure should also be assessed.

Focusing on what matters and reducing noise (deviations from perfection that have minimal impact,) will lead to a better outcome.

ASA also agrees self-regulation should be a first pillar of upholding high ethical standards in practice.

We further agree that market forces are not sufficient to ensure expectations are met so a system of regulation, qualifications, oversight, disclosure, and penalties are necessary to overcome self-interest and the impact of uncoded externalities.

ASA considers the recommendations while nuanced and complex address the real-world situation. We also note that any proposal will require review as to the effectiveness and cost of implementation – no solution will be set and forget.

QoN 4. In Submission 15, the Institute of Public Accountants suggested the establishment of the Financial Reporting Council as the single regulatory clearing-house for the accounting profession, with compulsory information gathering and information sharing powers and a power to sanction non-compliance with information gathering.

- a. Would you please provide your thoughts on that proposal?
- b. Related proposals are also made in submissions 15, 17, 20, 28, 31, and 51. The committee would welcome your thoughts on these further proposals.

The idea of a single-clearing house for the accounting profession, with compulsory information gathering and information sharing powers and a power to sanction non-compliance with information gathering has merit. There is a benefit in the FRC being that single-clearing house given its experience and responsibilities, and it being in a position to oversight a co-regulatory environment with multiple regulators and standard setters.

The risk of the FRC being perceived comprised of insiders and potential to be overly influenced by the industry can be achieved by proper oversight and periodic review of its effectiveness, as well as mature whistle-blower protections and obligations on market participants.

The suggestion of incorporating mandated contract terms, such as requiring consultants to expressly accept fiduciary duties to their clients, and to appoint, if required, a public interest advocate on any major contract, while outside ASA shareholder concerns makes sense in governance terms.

The Accounting Professional & Ethical Standards Board Limited (APESB) submission expresses the view that alternative methods could be used to address the issues of governance and transparency associated with partnership structures with relatively low implementation costs.

The suggestion of treating the large professional firms in a similar way to Public Interest Entities (PIEs) are treated for financial reporting purposes, benefits from being an existing framework which has previously been implemented – the challenges are known. Adopting this change by mandating the categorisation of large firms with substantial revenue, assets and workforces as PIEs and all that flows from that makes sense to us.

We agree with APESB that this approach would enable the relevant firms to maintain their partnership structure while being treated as reporting entities, thereby bringing transparency to their financial and operational practices and remuneration disclosures. This measure could also be applied more broadly to all professional services firms that provide services of interest, such as consulting services.

We also agree with APESB that the transparency of the provision of professional services could be enhanced through mandated disclosures on fees paid to all professional services firms.

Submission 31 (Dr Corinne Cortese, Associate Professor, Faculty of Business and Law, The University of Wollongong) proposes the formation of an independent group of regulatory

arrangements, (appointed to staggered terms of not more than five years, on a full-time basis and governed by a board comprising at least 75% of members who are not drawn from the Big Four).

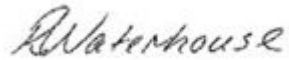
ASA considers appointing the FRC as a clearing-house as identified above, should, with appropriate accountability and periodic review, address the identified public interest/self-interest paradox. We concur that employment arrangements and tenure terms can contribute to regulatory entities failing to solve the problem they were set up to address or meet expectations that existed at commencement.

The content of submission 51 (Companies Auditors Disciplinary Board - CADB) supports the importance of an accountability framework and periodic review of the effectiveness of various ad hoc measures which are introduced in response to a problem. The lack of integration and nurturing to ensure the intended outcome of new legislation hoping to plug regulatory gaps or offset externalities could be remedied by the return of an entity similar to CAMAC (Corporations and Markets Advisory Committee.) We have no comment on whether CADB is where these powers should remain.

In summary in relation to QoN 4, ASA considers the existence of a single clearing-house with accountability for outcomes and overall probity and governance of providers to financial markets, will minimise the gaps in regulation and coverage which have been revealed by the PwC failure. Periodic independent public reviews of effectiveness of such a regime are necessary to ensure it is fit for purpose, whatever the future brings. The re-introduction of a CAMAC-like review for proposed legislative and regulatory changes will allow development of principles-based responses to emerging problems which should be dealt with in a nuanced complex world.

If you have any questions about the above comments, please do not hesitate to contact me (ceo@asa.asn.au), or Fiona Balzer, Policy & Advocacy Manager (policy@asa.asn.au).

Yours sincerely

A handwritten signature in black ink that reads "R Waterhouse". The signature is written in a cursive, slightly slanted style.

Rachel Waterhouse
Chief Executive Officer
Australian Shareholders' Association