Submission to the Treasury Consultation Paper: Regulation of accounting, auditing and consulting firms in Australia

June 2024

01 July 2024

Director
Corporate Conduct and Analysis Unit
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The Treasury
Langton Crescent
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Submitted via email: ccau@treasury.gov.au

Dear Director

Submission to Treasury Consultation Paper: Regulation of accounting, auditing and consulting firms in Australia

The Institute of Public Accountants (IPA) welcomes the opportunity to make a submission to the Treasury Consultation Paper on the regulation of accounting, auditing and consulting firms in Australia.

IPA is one of the three professional accounting bodies in Australia, having been established in 1923, and represents over 50,000 accountants, business advisers, academics, and students throughout Australia and internationally. Three-quarters of IPA's members work in or are advisers to small business and Small to Medium Enterprises (SMEs).

IPA acknowledges recent failings within the accounting profession and the consulting industry. In this submission IPA has sought to identify opportunities to rebuild trust through appropriate regulatory frameworks. IPA agrees that sensible reform can improve accountability across these sectors and should be pursued.

IPA believes that Treasury should consider the outcomes and recommendations from other relevant reviews and inquiries, some of which we mention below.

In this regard, it may be preferable to consider reforms that can be implemented as a package across the short, medium and long term.

IPA strongly believes that any reform proposals should be considered holistically and avoid disproportionate and duplicative regulatory burden, whilst also considering the cumulative burden.

IPA further believes the egregious actions of a few should not taint the majority of those who uphold the highest professional and ethical standards.

Specific responses to the questions posed in the Consultation Paper are addressed in the Annexure, with a further list of References also included.

IPA welcomes the opportunity to discuss with the Treasury any of the matters raised in this submission.

Should you require additional information or have queries, please contact Vicki Stylianou, Group Executive Advocacy and Professional Standards, Institute of Public Accountants at vicki.stylianou@publicaccountants.org.au.

Yours sincerely

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Annexure – IPA response to summary of consultation questions

Governance

1. **Are there adequate incentives to have appropriate governance practices in partnership structures?**
2. **How should governance mechanisms operate in large accounting partnerships? Does this reflect how governance is managed in practice?**
3. **Are there any key issues that are not captured above in relation to the governance mechanisms of large partnerships? Are there additional examples of benefits for non-stakeholders of good governance?**
4. **Are the current partnership limits fit for purpose for accounting firms? If not, what factors should guide decisions on an appropriate partnership limit and how should the limit be applied?**

IPA responds to this series of questions with the following consolidated response.

The last two decades have witnessed a plethora of high-profile corporate collapses directly attributed to audit failure as well as a number of scandals associated with some of the 'Big Four.'

In response to addressing these audit failures, a variety of remedies have been proposed such as banning auditors from providing consulting services, breaking up the oligopoly of the Big Four audit firms to improve competition, and introducing a public 'rating' system of auditors by regulators (see Coffee, 2019).

As a consequence of the Constitution of Australia and the Corporations power, *unincorporated* partnerships are regulated by the laws of the States and Territories (including fair trading regulators) rather than the Commonwealth. *Incorporated* partnerships are regulated by the Australian Securities and Investments Commission (ASIC) and are also subject to the directors duties (and accompanying penalties) under the *Corporations Act* 2001 (Cth) (*Corporations Act*).

Despite this, pursuant to the 'corporations' power in the Constitution of Australia, section 115(1) of the *Corporations Act* prescribes a limit for unincorporated partnerships of 20 partners (above which, the Act requires a partnership to become incorporated and be subject to the greater scrutiny and duties set out above).

However, section 115(2) of the *Corporations Act* permits the passage of regulations to amend this limit for particular types of partnerships.

Under Regulation 2A.1.01 of the current *Corporations Regulations 2001* (Cth), 'accountancy' partnerships are permitted to have a maximum of 1,000 partners before requiring incorporation and compliance with the stricter standards and duties which accompany an incorporated partnership.

It is IPA's position that the goal of improving governance standards within professional services firms is better achieved by focusing on reforms that require greater transparency from these firms.

IPA's position is that large unincorporated professional firms should be subject to clearer and more comprehensive governance standards, such as those that apply with respect to ASX listed companies (modified as necessary to reflect the absence of a need to protect shareholders and capital markets). IPA also considers that it would be possible to mandate requirements for disclosure of partner remuneration and reports of serious misconduct.

In IPA's view, this focus on individual responsibility would facilitate improved governance standards without prejudicing partnership participants.

IPA endorses Treasury's observations that the policy drivers behind the governance and transparency imperatives of companies are different to those of partnerships. IPA also agrees that '*(t)ransparency requirements for companies are also graduated depending on size.*'

IPA contends that a purpose-built regulatory regime should be considered given the size and reach of some of the largest partnerships, which otherwise escape close regulation and strict transparency requirements. We further contend that the regime should be based on occupational licensing requirements and the introduction of legislative definitions for 'accountants' and 'consultants.' Supervision and enforcement should be given due weight, which a purpose-built regime can provide more effectively than ASIC (see below).

IPA repeats its submissions to the Parliamentary Joint Committee on Corporations and Financial Services in its inquiry into Structural Challenges in the Audit, Assurance and Consultancy Industry, that:

- *amendments could be introduced into section 115 of the Corporations Act and the Corporations Regulations adopting a definition of large multidisciplinary partnership (LMDPs) specifying that a LMDP is any partnership over 400 partners (consistent with the legal profession) providing multiple service offerings and that a LMDP must be incorporated (thereby allowing the Commonwealth the power under the Constitutional corporations power to introduce a new regulator for LMDPs in legislation);*
- *legislation could be introduced establishing a regulator for LMDPs. This legislation could also include a protected definition of 'accountant' which could also apply to all accountants, whether part of an LMDP or otherwise. By way of example, this could be based on the existing definition contained in the IPA's by-laws, and that of the other Professional Accounting Bodies (PABs);*
- *the legislation establishing a regulator for LMDPs could also establish ethical and conduct requirements in legislation (unlike the current Standards which do not have legal force outside of the audit context);*
- *legislation could also be introduced adopting the International Ethics Standards Board for Accountants (IESBA) professional and ethical standards to apply to 'accountants, audit, assurance and consultancy' with the legislation also cross-referring to the existing ethical obligations on lawyers in existing legislation for legal employees of LMDPs; and*
- *legislation establishing a dedicated LMDP regulator could also provide for the power of the new regulator to receive referrals of whistleblowing conduct from the [PABs] and to refer whistleblowing matters back to the [PABs] for investigation and potential enforcement. This would also harmonise 'accountants' with the new model of reportable conduct which is already being introduced for registered tax agents.*

While governance standards and cultural norms internal to a firm clearly have a role to play, government also has a significant role in ensuring that criminal and civil pecuniary penalties are appropriately framed and applied consistently. This supports good culture and deters unlawful conduct. Given this, a well-resourced and effective regulator is essential.

Over the course of numerous consultations, inquiries and reviews, IPA has been critical of the performance and lack of transparency of ASIC. (Details have been provided in other submissions and in our answers to Questions on Notice in Parliamentary inquiries.) As set out above, IPA considers that a specific LMDP regulator would be preferable.

The new regulator should be a separate, independent regulator, tasked with the specific jurisdiction and powers to regulate, investigate and enforce against LMDPs.

IPA adopts this position both because of existing resourcing issues with ASIC and the fact that ASIC has had identified issues with enforcement and governance in multiple inquiries, such that no further expansion of its powers or jurisdiction can be justified at this time.

IPA's view is that ASIC is not like the US Securities and Exchange Commission. The disparity of funding, capability and enforcement outcomes militates against ASIC being given a further jurisdictional arm and enforcement power over this significant area of the economy, which requires dedicated focus, attention and expertise.

Professional standards, regulations and laws

5. **Are conflicts of interest managed appropriately by auditing and accounting practitioners? If not, what could be done to improve the management of conflicts of interest?**
6. **How effective are existing policies and regulations in separating the provision of audit and non-audit services in multi-disciplinary firms, particularly in the context of managing conflicts of interest to maintain auditor independence and objectivity? If they are not effective, how could they be improved?**
7. **How effective is the existing self-regulatory framework in ensuring the integrity and quality of services provided by professionals in the audit and accounting industries? If it is not effective, how could it be improved?**
8. **Are there any key issues that are not captured above in relation to the adequacy of standards, regulations and laws?**

IPA responds to this series of questions with the following consolidated response.

There is insufficient research that examines how accounting firms incentivise audit partners, nor is there a clear understanding of the impact of compensation arrangements on audit quality.

Notwithstanding this lack of evidence, research finds that revenue generation is a significant contributor to the salaries of audit partners (Coram & Robinson, 2016; Greenwood, Hinings, & Brown, 1990; Knechel, Niemi, & Zerni, 2013) and such audit partner compensation schemes have a negative effect on auditor quality (Trompeter, 1994; Vanstraelen, 2002).

In IPA's view, this culture would also raise significant risks for conflict of interest.

Economic fundamentals also suggest that incentives drive behaviour and if revenue generation drives compensation, then revenue generation may be given priority over and above conflicts of interest.

Literature in this area suggests that the compensation of individual audit partners should not be based on revenue generation alone, but also on an assessment of the audit partner's quality of work (Almer, Higgs, & Hooks, 2005; Liu & Simunic, 2005). There is anecdotal evidence suggesting that audit partner performance is assessed primarily on revenue generation and the amount of revenue the partner brings into the firm (Coram and Robinson, 2016).

Meanwhile, Jenkins et al. (2008) report on quality-threatening behaviours observed in a number of studies (e.g., DeZoort & Lord, 1997; Ettredge, Bedard, & Johnstone, 2005; McNair, Regulation of auditing in Australia 1991; Sweeney & Pierce, 2004). Recent reports by Switkowski and Broderick suggest these results remain unchanged.

These quality-threatening behaviours are usually associated with various forms of on-the-job pressures such as revenue generation reward-based systems appearing to provide stronger incentives for audit efficiency rather than effectiveness.

Accordingly, regulators should ensure that audit firms build remuneration incentives around audit effectiveness and prevention of conflicts of interest rather than on an excessive focus on efficiency and profitability.

More importantly, a rating system of audit firm quality developed by the regulator as well as introducing a more transparent system under which the audit regulator reviews the auditor's performance and publicly communicates its evaluation in much clearer language as suggested by Coffee (2019) should become an important component of the audit firm's compensation scheme.

It is only through such reforms and shifts in reward systems that Treasury will be able to reduce quality-threatening behaviours and thereby observe a cultural change in audit firms.

As Treasury recognises, the three PABs each have their own mechanism for managing members' compliance with APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (APES 110) which is largely modelled on the IESBA code. The PABs' powers to enforce APES 110, and thereby the consequences for members' non-compliance with it, are limited.
IPA conducts disciplinary processes under its Constitution, By-laws and Pronouncements.

The IPA Disciplinary Tribunal can impose sanctions on members for breaches including forfeiture or suspension of membership, fine, censure, admonishment or other penalty. The penalties and other systems and processes relating to IPA's co-regulatory function have been extensively reviewed over the last two years with major changes to be implemented in the coming months.

Whilst members cannot resign their membership in an attempt to avoid the disciplinary process, they don't require membership to continue to practice as an accountant. Even if their membership is eventually forfeited, they can continue to offer their services to the public.

In contrast, the Tax Practitioners Board (TPB) regulates tax practitioner conduct as specified in the *Tax Agents Services Act* 2009 (Cth) (TASA) with section 30-10 containing a statutory Code of Professional Conduct (TASA Code). The TPB has statutory powers to administer and enforce the TASA Code. If the TPB suspends or terminates a tax practitioner's registration, the practitioner is prohibited from practising as a tax practitioner. The TPB can also seek civil penalties to be imposed by a Court for any tax or BAS agent services provided by an unregistered practitioner.

In IPA's view, APES 110 should be legislated and given the force of law.[1] The PABs, or another dedicated regulatory body, should be granted powers to enforce the IESBA Code (or APES 110) and impose sanctions with real and lasting consequences to those who fail to comply with it. IPA proposes that a new, independent regulator for LMDPs be created. Such a regulator and the PABs can be granted these powers to 'cover the field' for enforcement. This is not unlike the UK model which grants 'delegated authority' to the PABs to supervise and enforce the standards. Having legislative support would greatly enhance the role of PABs in Australia to supervise and enforce the professional and ethical standards against their members. Non-members represent a significant regulatory gap.

A legislative regime which would regulate accountants as a profession, including by way of sanctions that would prevent them from practising, necessarily requires a prescribed definition of 'accountants.' The current system operates by way of individual self-regulation by voluntarily joining one of the PABs. In this system, any 'accountant' can effectively 'opt out' of their professional and ethical obligations by relinquishing their membership to the PABs. As noted above, even for those members who are subject to the disciplinary process, their membership may be forfeited, but this does not prevent them from continuing to offer their services to the public.

Regulation of 'consultants'

Similarly, the absence of any clear or agreed definition of 'consultants' renders them virtually impossible to effectively regulate. The IPA considers that the work of consultants often has potential for high systemic impact and risk on the functioning of the economy.

Recent controversies in the provision of consulting services demonstrate that there is a public interest in the competent, effective and ethical conduct of the consulting industry as a whole. The IPA points to scandals overseas such as Bain & Co's 'grave professional misconduct' in South Africa, which has resulted in a three-year ban from tendering for public contracts in the United Kingdom and a 10-year ban in South Africa. McKinsey & Company continues to face legal troubles for its past advisory work to opioid manufacturers despite reaching multiple settlements with government departments and health insurers collectively worth over AU$1 billion.

If the disparate nature of consulting services is such that an accurate definition to capture all relevant consultants for the purpose of regulation is problematic, an alternative proposal for regulation could include the scoping of the service recipient (rather than the service provider).

[1] To the extent auditing standards issued as legislative instruments under the *Corporations Act* by the Australian Auditing and Assurance Standards Board make 'relevant ethical requirements', the applicable requirements of APES 110 have legal enforceability due to Auditing Standard ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagement*.

For example, specific rules and regulations can be implemented for the provision of certain contracted consulting services to government clients.

This could be effected in any number of ways, such as by the Australian Public Service (APS) Commissioner issuing directions to apply specifically to externally engaged consultants or by expanding the scope of parts of the APS Code of Conduct.

Consideration could also be given to prescribing rules and regulations regarding the engagement of expert consultants in high-risk industries for the functioning of the economy, such as defence manufacturers or the 'Big 4' banking institutions.

Transparency, public information and reporting

9. **Recognising that companies are subject to reporting requirements that focus on protecting investors, should firms providing audit services to these companies be subject to enhanced transparency reporting beyond what is already mandated? If so, what additional information should be included in transparency reports? Should the information be verified?**
10. **Should audit firms be required to disclose any further specific information or key performance indicators to enhance confidence in the implementation of audit regulation? What costs would be involved?**

IPA responds to this series of questions with the following consolidated response.

The 2019 final report of the banking Royal Commission highlighted failures by the regulator ASIC. ASIC currently monitors audit quality. In IPA's view, ASIC is failing in its responsibilities in this area in a number of ways.

Research by Juneja et al. (2019) and Potter et al. (2019) shows that the quality of financial statements provided in Special Purpose Finance Reports (SPFR) is low, whereas Carey et al. (2014a,b) report that the incidence of financial statements lodged on the public record that do not purport to fully apply accounting standards is high.

These problems are not only a result of auditor failure but are also directly due to a lack of monitoring by ASIC of the lodgement of financial reports of private and not-for-profit entities and the activities of auditors who audit these financial reports.

For example, Carey et al. (2014a) and Potter et al. (2019) both report lack of timeliness in the lodgement of SPFRs with the regulator ASIC.

For example, Potter et al. (2019) report that nearly 64 percent of companies lodge late and that the average number of days for lodgement is 167 days, instead of the 120 days required by regulation for non-reporting entities.

Similarly, Carey et al. (2014a) report that 47.2 per cent of large proprietary companies lodging General Purpose Financial Statements lodged more than four months after year-end, and 47.9 per cent of companies lodging Special Purpose Financial Statements made late lodgements, with the timeliness of lodgements ranging from a minimum number of late lodgements of six days to 1,067 days (i.e., two years and nine months).

The evidence suggests that ASIC is not able to monitor and enforce high-quality reporting.

These high rates of late lodgements are unacceptable in a market that requires timely information, and it highlights the need to reform the lodgement process.

For years companies have elected to lodge their financial reports with ASIC either in an electronic document or in hardcopy (paper) forms. It appears that many private and not-for-profit entities elect to lodge hardcopies of their financial reports with ASIC, which are then scanned by ASIC staff into ASIC's lodgement system.

This antiquated lodgement system makes it difficult for ASIC to adequately monitor financial reports as it is difficult to electronically search a scanned postscript pdf document, unless OCR is enabled.

In order to significantly improve the monitoring and enforcement of companies' financial reports, the government should invest in building a suitable electronic lodgement system for the regulator that provides a quick translation of financial information into a proper database (see below). In this context, it would be relevant to consider mandating digital financial reporting systems, which over the years has become a global platform for business data exchange, albeit not in Australia.

Such a database would radically improve monitoring and enforcement of the financial reporting and auditing system, and it would change ASIC's current focus on minor compliance to a more holistic monitoring system that improves the overall transparency of financial reporting and auditing in Australia.

In IPA's view ASIC is not sufficiently resourced to ensure sustained high-quality financial reporting and auditing. This has significant flow-on consequences.

With respect to specific audit recommendations, we refer to the IPA's submission to the 2019 Parliamentary Inquiry into the Regulation of Auditing in Australia and to the consequent recommendations, which have been, and are being, implemented. For its submission, IPA had the benefit of the research and analysis undertaken by the IPA Deakin University SME Research Centre.

IPA is of the view that the concluding remarks from that submission are still relevant, as reproduced below:

> *The IPA Deakin SME Research Centre focused on outlining four areas that we believe will transform the auditing industry as well as improve the overall quality of auditing in Australia.*
>
> *These four areas are:*
>
> - *changing the current distorted revenue-driven compensation culture in audit firms by introducing alternative compensation schemes as well as through appropriate training;*
> - *Australian Securities and Investments Commission (ASIC) should be required to reform and introduce a better monitoring and improved enforcement system of auditors and the financial reporting system and government should facilitate this process by assisting in building a suitable electronic lodgment system for the regulator that provides a quick translation of financial information into a proper database;*

- *introduce a requirement within the Corporations Act 2001 (Corporations Act) that requires auditors to be responsible for reporting on the internal control systems of firms as required in the US under SOX404, and;*
- *ASIC could introduce a "rating" system of auditors.*

These four areas are derived from the research literature and from investigations by some members of the Research Centre who have been involved in producing research reports for the Australian Accounting Standards Board (AASB).

Enforcement and standard setting

11. **Does the preceding section capture the regulatory overlaps/gaps that should be addressed in audit, tax and insolvency? How could gaps or overlaps be addressed?**
12. **Are the powers and resources dedicated to regulatory oversight sufficient?**
13. **Are there any factors limiting the capacity of professional bodies to effectively carry out their self-regulation function?**
14. **Are the sanctions imposed for rule violations proportionate and effective in deterring future misconduct?**
15. **What are the costs and benefits of digital financial reporting?**

IPA responds to this series of questions with the following consolidated response.

Accountability framework

The Australian accounting profession operates in a co-regulatory environment with multiple regulators and standard setters, including the Accounting Professional and Ethical Standards Board (APESB), Australian Accounting Standards Board (AASB), Auditing and Assurance Standards Board (AUASB), TPB, Australian Taxation Office (ATO), Financial Reporting Council (FRC), and ASIC.

There is also the Professional Standards Councils (PSC) operating pursuant to Professional Standards Legislation. All three PABs have a Professional Standards Scheme which has mandatory reporting requirements and provides another layer of scrutiny.

Governance obligations – statutory and professional

IPA members are regulated under IPA's By-laws and Constitution, which include the need to comply with all relevant standards issued by the standard setters (APESB/AASB/AUASB). In addition, the services provided by our members are also subject to review by applicable regulatory authorities depending on the statutory registrations they hold (which depends on the services they provide).

For most IPA members, this often includes external regulatory oversight by ASIC, ATO, and/or TPB. In some cases, IPA members may be subject to two or three codes of ethics, including the TASA Code, Corporations Act, and APES 110.

Members may also hold a statutory registration as a Registered Tax Agent, Registered BAS Agent, Registered Liquidator, Registered Trustee in Bankruptcy, financial adviser (including authorised representative or credit provider), Registered Company Auditor, or Registered SMSF Auditor.

Even though the PABs do not have the same legislative enforcement powers as ASIC, the objectives of regulating, improving behaviour and culture, increasing professionalism (including integrity and competence), and serving the public interest are similar. This is essentially a co-regulatory model which we believe should be given due weight.

Instead, our members are subject to overlapping and at times conflicting requirements, creating additional compliance costs.

Accounting Professional and Ethical Standards

All members of the three PABs are required to adhere to APES 110 (largely based on IESBA Code) in addition to their respective Constitutions and By-laws.

This applies to all members regardless of whether they are in practice, work in business, corporates, academia, public sector and so on.

Members of the three PABs are required to comply with the full range of applicable professional and ethical standards issued by APESB. These standards relate to quality management for firms that provide non-assurance services, audit and assurance services, taxation, insolvency, outsourcing and numerous others. They cover supervision, management of conflicts of interest, risk management, and so on.

There is also mandatory Continuing Professional Development which includes extensive training in ethics. IPA offers a bespoke ethics course developed by Deakin University, as well as other training across a range of platforms.

IPA also has a quality review program that monitors and assesses member compliance with the standards as well as other regulatory requirements imposed by statutory agencies. The results of the program, as well as improvements, are reported annually and quarterly to APESB, FRC and PSC.

Complaints and discipline

IPA has an independent complaints and disciplinary system and processes to enforce compliance. If members become non-compliant their membership may be suspended or forfeited. These requirements are also monitored and enforced by the International Federation of Accountants (IFAC) and all PABs must comply with IFAC's Statement of Member Obligations.

However, as a non-statutory body, the IPA is limited in its co-regulatory function, and this is particularly evident in the operation of our investigation and disciplinary function. We are restrained by the inability to compel evidence from members in a disciplinary matter. We are able to breach members under our By-laws for not complying with a request for information, however, this gap enables members to refuse to disclose what might be important information or evidence.

IPA believes that a reasonably simple amendment to the Corporations Act or the Corporations Regulations could provide a major boost to consumer protection through enhanced regulatory oversight. We are not aware of any disadvantages to this proposed reform.

Limiting factors

Of major concern to the IPA, are the thousands of people who can legally call themselves an 'accountant' and provide numerous services to the public, without being subject to any accountability framework or governance requirements. This is a considerable regulatory gap for those who are not members of a PAB and who hold no statutory registration. These people are also able to operate in the consulting industry without regulatory requirements or scrutiny.

One possible model is to define the term 'accountant' in law, which would have the flow on effect of capturing at least some of these people in an appropriate regulatory framework, thereby enhancing consumer protection, accountability for government projects, and improving regulatory efficiency.

With respect to consultants, we note that even though the Institute of Management Consultants has developed an ethical code, consultants are generally not required to be members and so non-members are not subject to any ethical standards.

This position is understandable from a historical perspective given that consultants do not present themselves as having particular qualifications and are engaged by a generally sophisticated client base to perform a diverse range of work, to which a single ethical code would not necessarily be appropriate.

Clients are free to engage consultants on the contractual terms that are agreed, including terms relating to probity. However, recent issues demonstrate how the reliance upon consultants by the Australian public and private sectors is such that the public interest requires consultants to be subject to stricter standards.

Given the breadth of consulting work, it may not be practicable to mandate that persons providing consulting services must comply with a particular code. However, access to particular kinds of work, such as consulting for government or ASX-listed entities, could be restricted to consultants who register with an appropriate professional body or are otherwise subject to regulatory oversight. This is particularly important with the Treasury's impending requirement for mandatory climate-related financial disclosure commencing in 2025. Climate reporting and the myriad of sustainability reporting matters that are being developed would require the use of consultants who have the necessary expertise to assist entities in obtaining the information for their mandatory reporting and assurance.

Any ethical framework could be given legislative force and include penalties for non-compliance. It may be more expedient to strengthen the government procurement processes rather than to try and regulate such a diverse group of consultants. IPA suggests strengthening the Commonwealth Procurement Rules and ensuring adequate enforcement.

Digital financial reporting

Digital financial reporting provides many benefits, notably for more efficient comparison and analysis of the financial information, and by implication allows superior monitoring and enforcement of non-compliance by regulators. This in turn, would provide financial information users and the marketplace with more accurate, timely, relevant and reliable information. However, digital financial reporting requires investment in the infrastructure (eg software and systems) and staff with the necessary skills to ensure the accurate input of data into the systems. Consequently, large multinational companies that have the resources to implement the systems are likely to benefit the most from digital reporting. For this reason, IPA is of the view that digital financial reporting is unlikely to be voluntarily adopted by entities that are not large multinationals.

Internationally, digital financial reporting is increasingly being used, along with the International Financial Reporting Standard (IFRS) Foundation issuing IFRS Accounting Taxonomy and the IFRS Sustainability Disclosure Taxonomy. The IFRS Accounting Taxonomy tags financial statements prepared in accordance with IFRS Accounting Standards, while the IFRS Sustainability Disclosure Taxonomy tags sustainability-related financial information prepared in accordance with the IFRS Sustainability Disclosure Standards.

In Australia, digital financial reporting has been in development for a number of decades, and yet there are no definitive Australian guidance/standards in this area, nor is it on the work program of the AASB in the next few years. IPA is of the view that, given the advances in technology, there is a role for digital financial reporting. IPA also believes that an analysis is needed of the purposes of digital financial reporting in Australia, the reasons/barriers for the lack of impetus for its adoption to date, and whether digital financial reporting should be voluntary or mandatory for it to achieve its intended purposes.

Protection of whistleblowers

16. **What mechanisms are in place for whistleblowers to report corruption, rule-breaking, or other unethical conduct in your organisation or industry? Do these mechanisms provide sufficient protection?**
17. **Is there sufficient protection for employees and partners in accounting, auditing and consulting partnerships who want to report misconduct? If not, what gaps exist that may need to be addressed and how should they be addressed?**

IPA responds to this series of questions with the following consolidated response.

IPA's practice is to provide disclosure of a member's misconduct to other regulatory bodies where required by law and in the context of considering our privacy obligations to our members. IPA has published guidance on situations where disclosure of member information is provided to third parties.

Professional accountants in business and public practice are required to comply with section 260 and section 360 of APES 110 respectively. These sections contain specific requirements relating to Responding to Non-Compliance with Laws and Regulations.

This requires all members to report any actual or potential material breaches of laws and regulations to the relevant public authority (eg ASIC, ATO).

IPA supports its members with compliance with these requirements through foundation education courses, professional development activities, supporting materials such as IPA's Professional Practice Manual and IPA's Professional Practice Quality and Risk Management Manual.

Where required, IPA staff also assist with guiding members on their specific circumstances to ensure their privacy and confidentiality obligations to their client/employer are not compromised.

Despite recent reforms to whistleblowing protections, serious misconduct is only belatedly coming to light, in part because the reforms have not sufficiently encouraged whistleblowing.

Whistleblowing is critical because it has the dual effect of halting serious misconduct and creating transparency that engenders good professional conduct. An effective whistleblowing regime builds community trust and confidence by ensuring that misconduct is detected early, prior to serious harm.

There are opportunities to consider improvements to established whistleblowing processes. State and federal whistleblowing regimes overlap and are inconsistent. Recent commentary has suggested that whistleblowing regimes are underutilised and ineffective.

Given this environment, IPA submits that further consideration should be given to providing rewards/bounties to whistleblowers. The Joint Parliamentary Committee on Corporations and Financial Services has previously recommended reform to provide for the payment of rewards to whistleblowers whose disclosures led to the imposition of a penalty on a body. In the government response, the payment of rewards was identified as an issue to be considered in the post-implementation review of the reforms that were adopted.

Competition / resilience of the audit sector

18. **Is there sufficient competition to provide clients with choice in selecting accounting and audit services in the Australian market? If not, what factors prevent or impede such competition?**
19. **What are the barriers to entry into the market for auditing top 200 ASX-listed companies for 'mid-tier' firms?**
20. **What prevents top 200 ASX-listed companies switching to a 'mid-tier' firm as their company auditor?**
21. **Do the top 200 ASX-listed companies have any policies or practices that have the effect of excluding 'mid-tier' firms as company auditors?**
22. **Are there specific barriers to entry or challenges to competition in the accounting and audit sectors?**
23. **How does competition influence firms' compliance with regulatory requirements and industry standards?**
24. **Noting the competition issues raised in the audit sector, including the dominance of the largest accounting firms in the ASX 200 market, are there similar competition issues in other services provided by the accounting firms, including tax and consulting services?**

IPA responds to this series of questions with the following consolidated response.

While audit services and concomitant revenues are usually associated with publicly listed companies, the number of private companies in Australia is substantially larger compared to the number of publicly listed companies.

For example, there are more than 2.3 million actively trading businesses in Australia (ABS, 2019) and of these businesses, around 21,711 or 0.94 per cent are private entities that are required to lodge audited financial reports (ASIC, 2012) compared to 2,185 or 0.09 per cent public entities that lodge audited financial reports with the regulator.

Under the provisions of the Corporations Act, five categories of private and not-for-profit entities, namely, large proprietary, foreign-owned, unlisted public and public companies limited by guarantee

as well as small proprietary companies requested by ASIC, are required to file audited financial reports with the regulator.

According to Carey, Knechel and Tanewski (2013), the market for audit services in the large proprietary company sector alone is conservatively estimated to generate around $500 million in auditing revenue (i.e., excluding non-audit services).

Despite evidence that revenue from auditing is a diminishing proportion of the Big 4 firm's total revenue (30% in the E.U. (see Coffee, 2019) and between 14% and 21% in Australia in 2018), auditing services nonetheless generate significant revenues in Australia. For example, the audit industry in Australia generates about $1.4 billion from Big 4 audit firms alone. While consulting revenue among the Big 4 firms is growing as a proportion of total revenue, auditing 'compliance' services nonetheless remain a substantial component of the audit firm's business activities.

With such concentration, it has been noted by commentators that companies face a restricted pool of audit firms with experience in auditing listed companies. Where one of the major audit firms is providing non-audit services to a company, the pool of possible providers of audit services may be even more limited. Choice is further restricted if a company does not wish to contract audit services from a firm that audited a major competitor.

In addition to considering regulatory options to enhance competition noted above, it is IPA's view that government has a role to play and should seek to address the issue of concentration of accounting, auditing and consulting services through its procurement decisions as a customer.

Currently, SME providers face significant barriers to competing for government work. There may be some work that larger providers are uniquely well-placed to perform, but this is exceptional.

However, SME firms are generally required to comply with complex tender and panel requirements in order to compete for government work. These requirements are often formulated without due regard for the material administrative burden they impose on providers, and the associated costs that providers naturally seek to recover during the course of the provision of services to government.

As larger firms are better placed to invest in tender and panel processes, the result is that these processes prevent government from purchasing from SME providers even where those providers would be able to offer the best value for money.

In an effort to address this, government has established targets for 20% of contracts by value being sourced from SMEs. However, targets of these kinds have not always been effective, with a report from the Australian National Audit Office finding that two of the Big 4 firms had been classified as SMEs.

Additionally, while this target is an appropriate goal for government to set, it should not distract from the need to ensure that procurement processes should not structurally favour large firms that have well-resourced marketing departments.

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