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Introduction

In compiling my third edition of *Reflections*, I was struck by 12 commentaries in the monthly *GAAP Alert* newsletters that will be especially relevant for preparers, auditors and users in 2018.

The *GAAP Consulting* team has addressed several of these issues in greater detail at our GAAPinars and in face-to-face training during 2017.

I trust that you will find the pieces helpful.

Please feel free to share my *2017 Reflections* with your colleagues and contacts.

Financial reporting

Financial-reporting challenges are near (September)

Many accountants and auditors will have finished the bulk of their 30 June reporting commitments. A few might ask, What's the next set of challenges? There are many, and they are near.

The International Accounting Standards Board recently issued practice statement 2 *Making Materiality Judgements*. The AASB will shortly follow suit with something analogous (and did so in December).

While just 'guidance', this practice statement (along with the *Framework*) warrants serious consideration by directors, CFOs and auditors to ensure that the needs of users of financial statements are met. Remember, there are materiality rules in AASB 101 *Presentation of Financial Statements* that are supported by this practice statement.

On 31 December, comparatives determinations for AASB 15 *Revenue from Customer Contracts* and AASB 9 *Financial Instruments* began. Both 30 June and 31 December balancers by now should have completed the 'effect' assessment of these standards, made their transitional choices, drafted detailed accounting policies and prepared their opening balance sheets.

Many entities have yet to start even rudimentary understanding and implementation of these complex standards. They face a challenging 2018.

By now, listed entities should have assessed whether AASB 15 and AASB 9 require a continuous-disclosure notification. They should also be well advanced on their considerations of AASB 16 *Leases* and AASB 17 *Insurance Contracts*.

While not-for-profits have been granted a reprieve from AASB 15 and its related standard AASB 1058 *Income for Not-For-Profit Entities* until reporting periods commencing 1 January 2019, transition for others began on 1 January this year.

New year's day 2019 is also the date AASB 16 *Leases* becomes operative. Working back, comparatives as at 31 December 2018 and transition into AASB 16 and third-balance-sheet requirements as at 1 January rush towards us.

For-profit entities need to place on their financial-reporting agenda developments in the *Tax Transparency Code* and AASB Interpretation 23 *Uncertainty over Income Tax Treatments*. The latter will be effective from 1 January next year, the former much sooner.

Do you expect that your auditors will help you to solve these and other financial issues? Think again.

As reported in my Special GAAP Report *Financial Reporting and Auditing Considerations for 30 June*, ASIC reminded directors that they are primarily responsible for the quality of reports. They must ensure that management produces quality financial information. Companies must have appropriate processes and records to support information rather than simply relying on an independent auditor.

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The commission made the following specific warning: 'Auditors should be mindful of their responsibilities in the context of opining on financial reports, including any note disclosures. To maintain their independence, auditors should not be implementing new standards or advising on accounting treatments for their clients.'

Curing the blight of special-purpose financial statements

(December)

Lodgement of special-purpose financial statements has been a blight on quality financial reporting for decades – a disservice to users and legislative compliance.

The reporting-entity concept has been used and abused since its introduction in the 1990s as it is basically a self-assessment. This situation appears likely to change soon.

Previous attempts have been made by the Australian Accounting Standards Board to require entities that lodge statements with regulators, such as the Australian Securities and Investments Commission, to prepare general-purpose ones. The attempts stalled.

We have seen only one notable improvement, AASB 1053 *Applications of Tiers of Australian Accounting Standards*. There are still pockets of ignorance on its requirements.

ASIC's regulatory guide 85 *Reporting requirements for non-reporting entities* has been around since 2005. It provides guidance on applying the reporting-entity test and obligations for non-reporting entities. ASIC believes that non-reporting entities, which are required to prepare financial reports in accordance with Ch 2M of the *Corporations Act 2001*, should comply with the recognition and measurement requirements of accounting standards.

For some time now, the AASB has had academic research showing that special-purpose financial reports lodged with ASIC have produced 'variable' reporting – to be kind. The research has also shown that preparers and auditors have scant regard for regulatory guide 85. But there is no agitation for change or robust enforcement of 85.

Two recent developments suggest that this may well change with the AASB's planned approach to the revised IASB conceptual framework and the AASB's discussion paper *Improving Financial Reporting for Australian Charities*. These are reported below.

Is the reporting entity dead? Long live general-purpose financial reports and its various forms, I say.

Watch for developments this year.

Quality in financial reporting

(April)

ASIC-inspired corporate restatements of financial reports still occur, and the implementation of new AASBs is glacial.

It's a disturbing pattern, bearing in mind that I'm talking about listed entities, organisations that one presumes have competent boards and preparers and the resources to prepare high-quality (and compliant) statements.

I wonder how the non-listeds are progressing?

Some boards, preparers and auditors are failing to heed lessons from ASIC's financial-reporting surveillance program, restatements and the commission's targets for compliance. It's time for many entities to revise their approach to reporting and make the necessary investment to do it.

ASIC has reminded corporates to start to respond to the new suite of AASBs (9, 15 and 16). In particular, the commission stated that directors and management should ensure that progress is monitored against plans and action taken where milestones are not met.

The commission has also highlighted the importance of disclosure of qualitative and quantitative implementation of issued, but not yet operating, standards (AASB 101 *Presentation of Financial Statements*). Few have complied. Fingers crossed for better reporting in the future.

The year 2017 brings a transition for AASBs 15 and 9 and the preparation of the 'third' statement of financial position; time is running out. Decisions will need to be made about adopting AASB 16 early. There is much to do.

ASIC has cautioned auditors about any deep involvement with clients over the new standards. 'Auditors should be mindful of their responsibilities in the context of opining on financial reports, including any note disclosures. To maintain their independence, [they] should not be implementing new standards or advising on accounting treatments for their clients,' says the commission. Directors should also be mindful of this when helping their auditors with new standards and current-period transactions.

Directors need to be trained in understanding their company's financial statements – applying the principles of the Centro judgement and, where appropriate, challenging the accounting estimates and treatments used. They need to know the new standards' principles and how they affect businesses.

Further information to help directors can be found in ASIC information sheets 183 *Directors and financial reporting* and 203 *Impairment of non-financial assets: Materials for directors*.

Boards need to ask management the following questions.

1. Do we have adequate resources, competencies and systems to produce quality financial information for internal and external reporting?
2. How does ASIC's findings and targets affect our financial statements?
3. What is the business impact of AASBs 9, 15 and 16?
4. Are our detailed accounting policies compliant with AASBs and appropriately reflected in the financial statements?
5. How can we better communicate our key judgements in the financial statements?
6. How can we streamline the financial report to reflect better our business model and engage users?

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7. How can quality-assurance policies over the financial report be improved?
8. Do we need to seek independent advice on critical accounting issues?
9. How can we complement our auditors' 'perceived and actual' independence through our financial reporting?

Now is the time for boards and management to review their reporting and the templates they use to ensure compliance and accountability.

Preparers must act ethically (June)

Given the reporting season, I thought I should take the opportunity to remind preparers of their responsibilities under APES 110 *Code of Conduct for Professional Accountants*.

The code notes that members in business (MIB) in for-profit and not-for-profit entities are often involved in the preparation and reporting of information such as:

- Financial or management details, for example, forecasts and budgets
- Financial statements
- Management's discussion and analysis, and
- The management letter of representation provided to the auditors during an audit.

MIBs must prepare or present such information fairly, honestly and according to relevant professional standards so that the information is understood in its context.

An MIB who has responsibility for the preparation (CFO) or approval (governance/board) of general-purpose financial statements must be *satisfied* that they comply with applicable standards.

Where an MIB suspects that statements fail to comply, the member must:

- In all cases, notify governance and document the communication, and
- Qualify any declarations given by the MIB in compliance with legislative and regulatory requirements or the entity's reporting requirements.

Members of accounting teams must take reasonable steps to maintain information for which an MIB is responsible in a manner that:

- Describes clearly the true nature of business transactions, assets, and liabilities
- Classifies and records information in a timely and proper manner, and
- Represents the facts accurately and completely in all material respects.

Threats to compliance with fundamental code principles, for example, self-interest or intimidation, and threats to objectivity, professional competence and due care are created when an MIB is pressured (either externally or by the possibility of personal gain) to become associated with misleading information that might have been provided by others.

The significance of such threats will depend on factors such as the source of the pressure and the degree to which the information is, or may be, misleading. The significance of the threats must be evaluated and safeguards applied when necessary to eliminate them or to reduce them to an acceptable level.

Such safeguards include consultation with superiors within the employing entity, the audit committee or governance of the entity, or with a relevant professional body.

Where it is not possible to reduce the threat to an acceptable level, an MIB must refuse to be or remain associated with information the member determines is misleading.

Sometimes, an MIB may have been unknowingly associated with misleading information. Upon becoming aware of this, he or she must take steps to disassociate from it.

In determining whether there is a requirement to report, the MIB may consider obtaining legal advice. In addition, the member may consider resigning.

There are also requirements regarding 'acting with sufficient expertise' (section 330) and 'financial interests, compensation and incentives linked to financial reporting and decision making' (section 340) that preparers should also be familiar with.

Ethics in financial reporting matter.

Why I dislike models (March)

As we head towards another reporting date, are preparers and auditors going to be trapped again into using model financial statements?

Some jurisdictions, mainly involving the public sector, have mandated a particular model. This does a great disservice to those involved in the financial-reporting supply-chain by not allowing preparers to tell their own unique stories.

Central authorities are deeply misguided when they rate the consistency of financial statements as more important than their relevance.

Model financial statements can be a useful reference for preparers, but they must not be blindly followed. Financial reporting is about the provision of information for user decision-making. It is a thinking person's process; it must not be about mere compliance.

Accounting standards contain many disclosure rules that require entity-specific consideration, such as related-party disclosures, capital management and financial-instrument risk disclosures. Model financial statements cannot address all the permutations.

Judgements and estimates disclosures under AASB 101 *Presentation of Financial Statements* are also entity specific. Not to mention disclosures about going concern.

Transactions and events, such as a new financial instrument, discontinued operations, or a business combination, can arise during a financial year but are not well catered for in model financial statements.

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A model's summary of accounting policies might include several that are irrelevant for a particular entity. The inclusion of these (and related disclosures) contributes to financial-statement 'clutter', key messages obscured. An opportunity is lost to explain how specific policies have been applied.

Some eligible entities apply the reduced-disclosure regime (RDR). In the main they're not-for-profits. Important disclosures may be missed by a certain 'compliance' mindset by preparers and auditors. The challenge with RDR is to add relevant disclosures to those removed by arbitrary rules.

Congratulations to the increasing number of entities that have thought through and improved their financial reporting. They have articulated their business models and revised the financial report structure to reflect it, removing clutter through the thoughtful application of materiality and begun a journey towards plain English reporting. Informative, well-written integrated reports benefit stakeholders.

Contrast this to mindless adherence to a model set of financial statements.

Show leadership. Use the time between now and your next reporting season to start the journey towards improved financial reporting.

Remembering compilation responsibilities (July)

Many public practitioners and members in business will be compiling financial information this reporting season, but some – perhaps many – will be blissfully unaware of the professional requirements of APES 315 *Compilation of Financial Information* and place themselves at risk.

Most importantly, they might also deliver a sub-standard service to their clients and employers.

A compilation engagement is one in which a member in public practice or business applies professional expertise to assist governance in the preparation and presentation of financial information in accordance with an applicable financial-reporting framework.

There are specific exclusions from APES 315, including preparation of a taxation return and financial information prepared solely for inclusion in tax returns. Please, be aware of them.

While APES 315 is directed at members in public practice, members in business need to apply it to the extent practicable when they compile information for employers. This is especially so for the regulatory reporting requirements and compilation reports prepared under the Australian Securities and Investments Commission's class order CO 98/1417 *Audit relief for proprietary companies*.

When undertaking compilation engagements, members must comply with APES 110 *Code of Ethics for Professional Accountants*, in particular, section 100 *Introduction and Fundamental Principles of the Code* and relevant legislation. The former includes public-interest obligations, professional competence and due care. Do you know the accounting and ethical standards applying to financial reporting?

Independence is not required in compiling financial information. But where a member in public practice is not independent, an explanatory statement to that effect must be included in the compilation report.

Among other things, APES 315 requires:

- Compliance with this standard, and all applicable professional standards, laws and regulations*
- Documentation and communication of the terms of the engagement
- Consideration of whether the applicable financial-reporting framework is appropriate*
- Assessment of whether the compiled financial information is appropriate in form and content and free from misstatements*
- Where there is a misstatement, a consideration of performing specified procedures to correct it*
- Where assistance is provided to a client with significant judgements in general-purpose and special-purpose statements, there must be discussion with the client regarding them
- Preparation of working papers that appropriately document the work performed and that the engagement was carried out in accordance with APES 315 (and all other relevant professional standards*, including APES 320 *Quality Control for Firms*, and any applicable ethical, legal and regulatory requirements)
- Obtaining a written acknowledgment from the client of its responsibility for the reliability, accuracy and completeness of accounting records and disclosures of all material and relevant information
- Performance of sufficient reviews of the compilation engagement in accordance with the firm's policies and procedures before issuing a compilation report
- Communication to governance on a timely basis of any significant matters arising from the compilation engagement. Where information that indicates that a fraud, misstatement or illegal act has occurred, governance must be made aware of them as soon as practicable *
- The issue of a compilation report in prescribed format and circumstances, and
- Assessment of the effect on the compiled financial information of facts discovered subsequent to the date of the compilation report, discussion of the matter with the client, and action to be taken if appropriate. Reasons for the action must be documented.*

*Denotes requirements that are likely to apply to preparers who are members in business.

Members in business need also to be familiar with their ethical responsibilities under APES 110 section 320 *Preparation and Reporting of Information*, section 330 *Acting with Sufficient Expertise* and section 340 *Financial Interests, Compensation and Incentives Linked to Financial Reporting and Decision Making*.

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Some compiled information will be audited or reviewed, whereas others will have no assurance provided.

It is important that preparers understand and discharge their responsibilities in the interests of the public and users. Where compiled information is not reviewed or audited, preparers have a heightened exposure.

Uncertain tax positions have far-reaching implications (August)

It might be unclear as to how tax law applies to a particular transaction or circumstance. The acceptability of a particular tax treatment under law might not be known until a taxation authority or a court takes a decision some time later.

A dispute or examination of a particular tax treatment by an authority may affect an entity's accounting for a current or deferred tax asset or liability. AASB interpretation 23 *Uncertainty over Income Tax Treatments* addresses these circumstances with far-reaching implications that will significantly affect many entities.

Interpretation 23 incorporates interpretation 23 *Uncertainty over Income Tax Treatments* of the international financial-reporting interpretations committee and issued by IASB.

Interpretation 23 clarifies how to apply the recognition and measurement requirements in AASB 112 *Incomes Taxes* when there is uncertainty over income-tax treatments. In such a circumstance, an entity must recognise and measure its current or deferred tax asset or liability, applying the requirements in AASB 112 based on taxable profit (or loss), tax bases, unused tax losses, unused tax credits and tax rates determined in applying Interpretation 23.

An 'uncertain tax treatment' is a tax treatment for which there is uncertainty over whether the relevant taxation authority will accept the treatment under law.

Interpretation 23 specifies that an entity must:

- Identify uncertain tax treatment(s)
- Determine whether treatments should be assessed separately or together based on an approach that *better predicts* the resolution of the uncertainty
- Assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations
- Conclude whether it is probable or not that the taxation authority will accept an uncertain tax treatment
- Where it is not probable that the taxation authority will accept an uncertain treatment, the effect of uncertainty must be reflected in determining the related taxable profit (or loss), tax bases, unused tax losses, unused tax credits or tax rates by either the most likely amount or the expected value. The choice of method depends on which method the entity expects to better predict the resolution of the uncertainty

- Reassess a judgement or estimate if the facts and circumstances change or as a result of new information that affects the judgement or estimate, and
- Apply the interpretation's transitional provisions.

Interpretation 23 applies for annual reporting periods beginning on or after 1 January 2019.

Implications include:

- Directors will have to assess continually the aggressiveness of tax positions taken
- The probability threshold for deferred tax liabilities will be applied at an earlier point and could result in more tax liabilities being recognised
- Entities will need to consider the tax office's public guidance as to what it is likely to dispute and its success in disputed matters in determining the likely resolution
- Listed companies will also need to ensure that they appropriately disclose uncertain and disputed tax positions under their continuous-disclosure obligations, and
- Consideration of 'issued but not yet operative accounting standards and interpretations' as well as the disclosures of accounting estimates and judgements, and contingencies.

Directors and CFO's should also be mindful of the AASB Invitation to Comment Draft *Appendix to the Tax Transparency Code*. The Board of Tax requested that the AASB develop guidance to assist businesses meet the TTC recommendations for the suggested tax reconciliation and calculation of the TTC ETR.

Entities would be well advised to begin considering the interpretation's implications as well as forthcoming *Tax Transparency Code*.

Ethics

Ethics need your urgent attention (February)

New standards and ethics are changing the landscape for accountants and auditors.

And the latter are flying under the radar. In my experience, many preparers and auditors have a limited understanding of the 143-page *APES 110 Code of Ethics for Professional Accountants*. So, there is much to do.

Let's start with the first of these changes, the 45-page exposure draft 02/16 *Proposed Amendments to APES 110 Code of Ethics for Professional Accountants due to revisions to IESBA's Code of Ethics for Professional Accountants*. The title fails to concern us overly, but the content and timeline for application should.

The proposed ethical changes are significant and affect us all. Let me share with you a glimpse of what is proposed.

There are new rules for responding to non-compliance with laws and regulations (NOCLAR) and the provision of non-assurance services for audit and assurance clients.

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The NOCLAR amendments are a framework aimed at guiding members on how to act in the public interest when they become aware of non-compliances or suspected non-compliances committed by a client or employer.

Potential illegal acts could be a breach of a range of laws and regulations concerning fraud, corruption and bribery, money-laundering, terrorist financing and proceeds of crime, securities markets and trading, banking and other financial products and services, data protection, tax and pension liabilities and payments, environmental protection and public health and safety.

The majority of the proposed NOCLAR amendments are included in new sections 225 (members in public practice) and 360 (members in business).

Proposed amendments for non-assurance services include:

- The removal of exceptions permitting members in public practice to provide accounting and bookkeeping services, including preparation of tax calculations for the purpose of accounting-entries preparation for audit clients that are not public-interest entities (PIEs)
- Additional guidance and clarification regarding what constitutes management responsibility (sections 290 and 291), and
- Enhanced guidance and clarification regarding the concept of 'routine or mechanical' services relating to the preparation of accounting records and financial statements for audit clients that are not PIEs (section 290).

It's intended that the proposed amendments will operate from 15 July 2017.

And they're just the beginning of ethical changes.

The code is on my agenda – it should be on yours.

NOCLAR affects us now

(May)

It's a game-changer, the bundle of non-compliance-with-laws-and-regulations (NOCLAR) requirements released by the Accounting Professional & Ethical Standards Board.

No longer can accountants ignore *suspected* non-compliance with laws and regulations.

NOCLAR applies to all of us – accountants in commerce and industry, public sector and not-for-profits, as well as accounting firms. We must act in accordance with a heightened public interest in compliance.

NOCLAR covers acts of omission or commission, intentional or unintentional, committed by a client or those charged with governance, by management or by other individuals working for or under the direction of a client.

Examples of NOCLAR are:

- Fraud, corruption, bribery
- Money-laundering, terrorist-financing, proceeds of crime
- Securities markets and trading
- Banking, financial products and services
- Data protection
- Tax and pension liabilities and payments
- Environmental protection, and
- Public health and safety.

There are many real-life examples of breaches. You can read about them daily in the Press. So, it's time we asked ourselves what we would do if we suspect non-compliance.

The new ethical rules respond to the following key public-interest concerns:

- The duty of confidentiality in the code's acting as a barrier to the disclosure by professional accountants of potential NOCLAR to public authorities
- Professional accountants and auditors simply resigning from employer/client relationships without NOCLAR issues being appropriately addressed, and
- A lack of guidance to help accountants in working out how best to respond to potential NOCLAR, a situation that may often be difficult and stressful.

The responsibilities under of APES 110 *Code of Professional Ethics for Professional Accountants* differ depending on whether an accountant is:

- An employee of an entity
- A senior professional (part of the management team or a member of governance)
- An auditor of an entity, and
- A member in public practice interacting with his or her client in a professional capacity.

The NOCLAR rules are incorporated in new sections 225 (Members in Public Practice) and 360 (Members in Business) of APES 110.

Auditors' responsibilities for NOCLAR will be addressed in the forthcoming revised auditing standard ASA 250 *Consideration of Laws and Regulations in an Audit of a Financial Report* that will be operative for financial reporting periods commencing after 15 December.

NOCLAR rules are effective from 1 January 2018.

Much to do in such a short-time. We need to understand NOCLAR, inform stakeholders, develop internal policies and procedures, and train. You can't ignore NOCLAR or just wing it. Get started now.

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The challenge of compliance and whistleblowing (October)

Whistleblowing and the business risks associated with non-compliance with laws and regulations are emerging as key considerations for boards, management, risk professionals (such as internal auditors), external auditors and accountants in public practice.

From our recent GAAPinars on NOCLAR for accountants and auditors – and press coverage – you should be well aware of the following examples:

- Underpayment of wages and other breaches of the Fair Work Act (FWA) at food franchises, convenience stores, petrol outlets
- Fair Work Ombudsman v Blue Impression Pty & Ors [2017] FCCA 810 (28 April 2017) – an accountant held to be an accessory to employer breaches of the FWA
- Austrac v CBA
- Austrac v Tabcorp
- SEC v Rio Tinto & Ors (importance of an internal whistleblower), and
- Volkswagen emissions scandal.

There is an alignment of standards, legislation, and business practices and judgements that pose challenges to us all.

The new ethical and auditing standards on non-compliance with laws and regulations (known as NOCLAR) that come into effect in January. These affect all professional accountants under APES 110 *The Code of Conduct for Professional Accountants*.

External auditors (and their audit teams) have additional responsibilities under ASA 250 *Consideration of Laws and Regulations in an Audit of a Financial Report*, and associated amendments to other auditing and assurance standards. Auditors will need to engage with their clients and component auditors, to ensure that there is a clear understanding of everyone's new responsibilities.

Accounting firms will need to ensure that non-audit partners and their teams know their NOCLAR responsibilities and how these can affect additional responsibilities imposed on an audit practice.

Importantly, legislative developments will lead to protection of whistleblowers. This will encourage more external whistleblowing. Entities will face more regulator intervention as a result.

All entities (and professional accountants) must know of their legal and ethical responsibilities. A good place to start with the risk register and associated risk-management policies and procedures. Haven't got them? Get started.

Governance (including those of accounting firms) must set the tone at the top. There must be a good understanding on the new responsibilities and the actions required.

Non-compliance with laws and regulators (and fraud) are mostly identified by tip-off. Entities need to have robust policies and procedures to encourage whistleblowing so that risks can be managed internally, and consideration given as to whether self-reporting to the relevant regulator is required or desirable.

Better to be proactive about heightened exposures to risk rather than reactive to a regulator's enquiries and possible legal action and reputational damage.

Many lessons will be learnt in the coming years on this seismic shift. No doubt some entities and professional accountants will be found wanting – don't let it be you or your organisation.

Audit

Audit assistance with AASBs 15, 9 and 16 (January)

The forthcoming standards on revenue, financial instruments, and leases pose various challenges for auditors and their clients, including to what degree an auditor may assist.

The code of ethics for professional accountants provides the framework for auditors' decision-making. It states explicitly that management is responsible for the preparation and fair presentation of financial statements.

Providing an audit client with accounting and book-keeping services, such as preparing the accounting records or financial statements, creates a self-review threat when the firm subsequently audits them.

The code specifies a conceptual approach to addressing threats to its fundamental principles, including an auditor's independence of mind and in perception.

The code declares no difference between general-purpose and special-purpose financial statements.

An audit firm is prohibited from preparing financial statements for an audit client that is a public interest entity (PIE) where the firm will express an opinion or prepare financial information that forms the basis of the statements.

A PIE is a defined term – a listed entity. The code also specifies other entities that satisfy PIE conditions – many and widely-ranging stakeholders – and thus are likely to be classified as PIEs. It requires audit firms to determine entities and categories to be treated as PIEs.

Unfortunately, some firms do not have a policy on PIEs, placing them at risk of breaching independence requirements.

For audit clients that are not PIEs, an audit firm may prepare accounting records and financial statements if the services are routine or mechanical in nature, and any 'self-review threat' created is reduced to an acceptable level.

Is the transition to AASBs 15, 9 and 16 routine or mechanical? I think not.

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Self-review threats need to be evaluated and safeguards applied to eliminate them or reduce them to acceptable levels. Safeguards may include performance of the service by an individual who is not part of the audit team. This decision-making process needs to be documented.

The code recognises that the audit process necessitates a dialogue between auditor and client. This process may involve the application of accounting standards that do not create threats to independence.

It also recognises that a client may request technical assistance on accounting issues, providing examples, say, of conversion of existing financial statements from one reporting framework to another. This type of help is viewed as generally unlikely to threaten independence provided the firm does not assume a management responsibility.

The analogy is drawn by some auditors that they can provide technical assistance with the application of the AASBs 15, 9 and 16 – a slippery slope.

The code does not have an exclusion to independence rules when a client is small and management and governance has limited or no financial-reporting competence. Such circumstances can be a risk to the auditor if he or she just wants to help a client meet its reporting obligations.

Governance and management must rise to the challenge of understanding and implementing AASBs 15, 9 and 16, and just not think that the auditor will do this for them.

ASIC's audit-inspection results disappoint (November)

On the eve of the 30 June reporting period, the Australian Securities and Investments Commission released the results of its audit-firm inspections for the 18 months to 31 December 2016.

They disappointed ASIC commissioner John Price.

Many auditors would not have yet had the opportunity to consider the findings or plan their responses. They need to do so now.

ASIC reviewed 390 key audit areas across 93 audit files at firms of different sizes. It found that in 25 per cent (19 per cent in previous reviews) of key areas, auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement.

Interestingly, in 15 cases ASIC raised financial-reporting concerns with the company concerned or the auditor, who followed up with company matters identified. In 12 of these cases, the companies made material changes to the amounts of both the net assets and profits in the subsequent period, or restated amounts. Two further companies made additional disclosures.

Commissioner John Price said: 'Given the efforts by firms to improve audit quality and the consistency of execution of audits, this is a disappointing result.'

Audit firms need to continue to pay particular attention to auditing asset values and revenue and maintaining a strong culture of quality. The latter includes sending strong messages from firm leadership, setting expectations, leading by example, coaching, robust review processes, and effective accountability mechanisms.

ASIC noted that it remains important for auditors to focus on the sufficiency and appropriateness of audit evidence, the level of professional scepticism exercised, and appropriate use of the work of experts and other auditors.

The commission's report outlines where auditors need to improve and areas it will inspect in future.

ASIC has also released two information sheets related to audit quality: *Improving and maintaining audit quality*, which outlines considerations for auditors to improve and maintain audit quality (INFO 222), and *Audit quality: The role of others*, which outlines how parties other than audit firms can contribute to audit quality (INFO 223). They are helpful.

So, what to do?

- Audit leadership groups should discuss and understand the ASIC findings, information sheets, and lessons from corporate restatements
- Check out our GAAPinar *Learning the lessons from ASIC audit inspections* (14 December) that delves into the detail of ASIC audit-inspection programs and other quality control issues. For those that can't make the date, recordings will be available
- Benchmark audit files and policies against ASIC findings
- Identify the root causes of findings from your own quality reviews of audit files and systems, perhaps with help from an external reviewer, and
- Develop a plan to improve continually audit quality – this many include training, increased supervision and review, incorporating the commission's findings into peer-review programs, and added emphasis on quality-control systems and procedures. The plan needs to be reported against actions at meetings of the audit executive.

ASIC's and the market's patience will be severely tested if lessons fail to be learned and audit quality does not improve. Does the future hold sanctions against auditors such as fines, enforceable undertakings, or publishing surveillance results for individual firms? One only has to look at the UK and US for tougher enforcement regimes.

The commission's audit inspections and information releases provide rich sources of information that have significant value. Use them to minimise your audit and business risks.

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And please ...

Remember that, even when you aren't working face-to-face with the *GAAP Consulting* team, you can stay up-to-date with financial-reporting developments.

GAAP Alert is a free monthly emailed newsletter that alerts you to the latest Australian and international developments in GAAP, GAAS, ethics and regulations. We reported over 250 items during the year. Now, I call that keeping you informed. You can subscribe to *GAAP Alert* at www.gaap.com.au.

Apart from *GAAP Alert*, we have our periodic *Special GAAP Reports* and quarterly *NFP Risks and Compliance* newsletter as well as *GAAPinars* and our face-to-face training programs.

We're on LinkedIn and Twitter.

You can also subscribe to the *ReportFraud and NOCLAR* newsletter at www.reportfraud.org.au. Its free.

Questions or assistance required? Please contact me, Colin.



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