



SUBMISSION

BY THE AUSTRALIAN TREASURY

TO THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

28 MARCH 2003

REGISTRATION AND OVERSIGHT OF FOREIGN PUBLIC ACCOUNTING FIRMS

Introduction

This paper is provided in response to the 4 March 2003 invitation by the Public Company Accounting Oversight Board for written comments on its proposals for the registration of foreign public accounting firms and on the appropriate scope of the Board's oversight of such firms. It was prepared by the Australian Treasury in consultation with the Australian Securities and Investments Commission.

2. The paper is also aimed at assisting discussion of these issues at a public round-table meeting to be hosted by the Board on 31 March 2003.

Australian institutional framework

3. Briefly, oversight of the audit profession in Australia is a co-regulatory responsibility of the profession and the Government.

4. Government involvement in this area is a matter for the Treasury portfolio through:

- the Treasurer, the Hon Peter Costello, MP and the Parliamentary Secretary to the Treasurer, Senator the Hon Ian Campbell;
- the Department of the Treasury — responsible for advising the Government on relevant policy;
- the securities regulator, the Australian Securities and Investments Commission (ASIC) — responsible for enforcement of the financial reporting and audit provisions of the *Corporations Act 2001*, including the registration and supervision of individual company auditors. There is currently no registration of audit firms in Australia. ASIC also refers disciplinary matters relating to individual auditors to the Companies Auditors and Liquidators Disciplinary Board;
- the Companies Auditors and Liquidators Disciplinary Board (CALDB) — a body established under the *Australian Securities and Investments Commission Act 2001* to hear disciplinary cases against individual auditors. The CALDB can cancel or suspend an auditor's registration, censure an auditor, or require him or her to undergo additional training, but, as an administrative rather than a judicial body, cannot impose fines or custodial sentences.

5. The accounting profession, through the professional bodies (The Institute of Chartered Accountants in Australia, CPA Australia, and the National Institute of Accountants), operates a self-regulatory framework to maintain high professional standards for accountants.

- Features of this framework include high entry standards, requirements for continuing professional education, and comprehensive professional rules and standards. Auditors in Australia must follow professional ethical rules issued by the International Federation of Accountants which are promulgated in Australia by the professional accounting bodies.
- The professional accounting bodies run quality assurance programs which review each practice periodically to ensure that quality control policies and procedures are maintained. Reviews include an examination of professional independence, client evaluation, professional development, guidance and assistance, conduct and supervision, internal inspection and review, assignment of personnel to engagements, and employment and promotion.

- The professional accounting bodies also operate formal complaints and disciplinary procedures in relation to the conduct of their members.

Recent policy developments

6. The Government recently undertook a wide-ranging review of corporate disclosure issues in the light of developments overseas and domestically. On 18 September 2002, it released a policy proposal paper, *Corporate Disclosure. Strengthening the financial reporting framework*, as part of its ongoing program of corporate law economic reform.

7. The paper (copies of which have been provided to Board staff) includes proposals aimed at strengthening auditor independence — for example, by tightening rules governing employment and financial relationships between auditors and their clients, mandating audit committees for larger listed companies, requiring better disclosure of audit and non-audit fees, requiring audit committees to explain why certain non-audit services do not compromise independence, and requiring audit partner rotation after 5 years.

8. The paper also proposes a strengthening of corporate disclosure through listing rules of the Australian Stock Exchange and changes to Australia's continuous disclosure regime.

9. In addition, the paper proposes that an existing Government agency, the Financial Reporting Council (FRC) — which currently provides oversight of the accounting standard setting process in Australia — assume new responsibilities for:

- overseeing auditing standard setting arrangements, with the standard setter becoming a Government agency rather than a body established and funded by the accounting profession; auditing standards will also be given the force of law;
- monitoring and reporting on the nature and adequacy of the systems and processes used by audit firms to deal with issues of auditor independence;
- monitoring and reporting on the response of companies in complying with audit-related disclosure requirements;
- advising the Government and accounting profession on continuing steps to enhance auditor independence;
- monitoring and assessing the adequacy of the disciplinary procedures of the accounting bodies; and
- promoting and advising on the adequacy of the teaching of professional and business ethics by the professional accounting bodies and tertiary institutions.

10. It is not envisaged that the FRC would have regulatory responsibilities. This would remain a matter for ASIC as the securities regulator. However, the FRC would have a key role in understanding and reporting to the Government (and the public) on audit firm processes and auditor independence issues more generally. For that purpose, it would be given appropriate powers to require reports and information from audit firms. The FRC would also work with the professional accounting bodies to review and where necessary strengthen their quality assurance programs and disciplinary procedures.

11. The Government has considered submissions from stakeholders on these proposals and is currently examining implementation issues. Exposure draft legislation is being developed for release by June 2003, with legislation expected to be enacted by December 2003 with a likely effective date in early 2004.

12. In summary, while changes to the Australian regime for the regulation and oversight of the audit profession remain under consideration, the general approach set out in the policy proposals paper represents the current thinking of the Australian Government.

13. This is a necessarily brief overview of Australian arrangements. We would be glad to provide additional information if required.

14. The Treasury, FRC and ASIC look forward to establishing a constructive working relationship with the PCAOB and would be willing, where relevant, to explore mechanisms such as memoranda of understanding to help underpin operational aspects of this relationship.

PCAOB proposals for registration and oversight of foreign public accounting firms

15. Australia has a robust corporate governance framework and most audits are conducted professionally and competently, with full regard to the interests of shareholders, the need for independence, and professional ethical rules. The United States and Australia share the same regulatory objectives in this area. Our regulatory, oversight and enforcement mechanisms will inevitably differ. However, we see a common interest in avoiding regulatory overlap and duplication wherever possible. ASIC is active in policing compliance with financial reporting and auditor obligations under the Corporations Act.

16. Australia has around 34 companies which are SEC registrants. While they include some of Australia's largest listed companies, their debt and equity raisings in the United States result in comparatively minor exposure for US investors.

17. From a United States perspective, there may be advantages, particularly given scarce regulatory resources, in reaching understandings with the relevant Australian authorities that would allow "equivalent regime" recognition, enabling Australian firms which audit SEC registrants to be exempted from Board rules. The FRC's annual reporting requirements for Australian audit firms could be developed in consultation with the Board, with information-sharing between the FRC and the Board covered by a memorandum of understanding.

18. Such an approach would also reduce compliance costs for Australian audit firms in meeting the detailed registration and periodic reporting requirements expected to be imposed by the Board, and undergoing triennial Board investigations. These costs would represent a larger compliance burden in the context of the Australian capital market than in the United States, bearing in mind also that an Australian audit firm may only audit 6 or 7 SEC registrants.

19. We understand that Australian arms of the 'Big 4' audit firms would favour an approach along these lines (although we also understand that the 'Big 4' are approaching these issues on a global basis).

20. We note that, in light of the requirements of the Sarbanes-Oxley Act and existing US rules applying to foreign audit firms that participate in audits of US public companies, the Board has concluded that foreign audit firms will be required to register with it. If this position is confirmed, exemption for Australian audit firms could relate to updating of registration information, periodic reporting, and inspections.

Questions

21. Answers to some of the questions posed in the Board's briefing paper of 4 March 2003 are provided below.

The registration process

- (1) Is it feasible for foreign public accounting firms to register within 180 days of the date of the Commission's determination that the Board is capable of operating? Should foreign public accounting firms be afforded some longer period (eg, an additional 90 days) within which to register?
 - Treasury and ASIC do not have a clear sense whether the 180 day period is feasible. This is more a matter for Australian audit firms, which we understand will be represented at the 31 March meeting. While we understand that information requirements for US firm and foreign firm registration are equivalent, it is not clear whether they have the same starting point — ie, if US firms already have certain information readily accessible due to current US regulatory requirements.
- (2) Are there any portions of Form 1 that are inapplicable, or that should be modified, in the case of non-US applicants?
 - None obvious from a policy or regulatory viewpoint. However, Australian audit firms may have views on the feasibility of providing certain information, or on whether the information sought will be meaningful in all cases.
- (3) In addition to the information required by Form 1, is there any additional information that should be sought from non-US applicants?
 - See answer to question (2).
- (4) Do any of the Board's registration requirements conflict with the law of any jurisdiction in which foreign public accounting firms that will be required to register are located?
 - While there have been concerns expressed in Australia about the extra-territorial reach of the Sarbanes-Oxley Act and rules made under the Act, we are not aware of any conflict of law issues in relation to the audit oversight provisions.
- (5) In the case of non-US firms that are required to register because they play a substantial role in the preparation and furnishing of an audit report on a US issuer, is the Board's definition of "substantial role" in Rule 1001(n) appropriate? In particular, should the 20 per cent tests for determining whether a foreign firm's services are material to the audit, or whether the foreign firm performs audit procedures with respect to a significant subsidiary, be changed? Would a 10 per cent threshold more realistically capture firms that materially participate in the preparation or furnishing of an audit report?
 - Audit firms would be in a better position to comment on whether 20 per cent of total engagement hours or fees is the appropriate threshold for 'material services' provided by one audit firm to another. With respect to the size of subsidiaries and other component entities of issuers, a decision on the materiality threshold would appear to depend mainly on Board and

SEC assessments of appropriate regulatory effort to achieve desired investor protection outcomes.

- (6) Should the requirements to register be different for foreign public accounting firms that are “associated entities” (as defined in the Board’s rules) of US registered public accounting firms than for firms that are not associated with US registered firms?
- We understand that the Australian arms of the Big 4 accounting firms are independent separate legal entities from their US and international counterparts.

Board oversight of foreign registered public accounting firms

- (1) Should registered foreign public accounting firms be subject to Board inspection? Could the Board, in some cases, rely on home-country regulation in lieu of inspection of foreign public accounting firms? If so, under what circumstances could this occur?
- See discussion in paragraphs 15-20 above.
- (2) Aside from Board inspection, are there other requirements of the Act from which foreign public accounting firms should be exempted? If so, under what circumstances?
- See discussion in paragraphs 15-20 above.
- (3) Are there requirements different from those the Act imposes on all registered public accounting firms that the Board should apply to foreign public accounting firms?
- See discussion in paragraphs 15-20 above.
- (4) Should the Board’s oversight of foreign registered public accounting firms that are “associated entities” (as defined in the Board’s rules) of US registered public accounting firms be different than its oversight of foreign public accounting firms that are not associated entities of US registered firms? Should the US registered firm have any responsibility for the foreign registered firm’s compliance with the Board’s rules and standards?
- We understand that the Australian arms of the Big 4 accounting firms are independent separate legal entities from their US and international counterparts.