

The Institute of Chartered Accountants in Australia

Annual report on the Quality Review Program

For the year ended 30 June 2006



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The Institute of Chartered Accountants in Australia
Annual report on the Quality Review Program

- 1. Does your practice have a Quality Control Manual, or similar document?
- 2. Does your practice ensure independence is maintained?
- 3. Are the Training & Development hours adequate?
- 4. Does your practice use standard working papers?



The Institute of
Chartered Accountants
in Australia

The Institute of Chartered Accountants in Australia

The Institute of Chartered Accountants in Australia (the Institute) is the professional body representing Chartered Accountants in Australia. Our reach extends to more than 55,000 of today's and tomorrow's business leaders, representing some 44,000 Chartered Accountants and 11,000 of Australia's best accounting graduates who are currently enrolled in our world-class postgraduate program.

Our members work in diverse roles across commerce and industry, academia, government, and public practice throughout Australia and in 107 countries around the world.

We aim to lead the profession by delivering visionary thought leadership projects, setting the benchmark for the highest ethical, professional and educational standards and enhancing and promoting the Chartered Accountant brand. We also represent the interests of members to government, industry, academia and the general public by actively engaging our membership and local and international bodies on public policy, government legislation and regulatory issues.

The Institute can leverage advantages for its members as a founding member of the Global Accounting Alliance (GAA), an international accounting coalition formed by the world's premier accounting bodies. The GAA has a membership of 700,000. It promotes quality professional services to share information and collaborate on international accounting issues.

Established in 1928, the Institute is constituted by Royal Charter. For further information about the Institute, visit charteredaccountants.com.au

Disclaimer

The Quality Review Program is not an audit of the practice or files of any members of the Institute of Chartered Accountants in Australia. By conducting the Quality Review Program and reviewing particular members in the course of the Quality Review Program, the Institute is NOT certifying or representing that the work done or the opinions given by the member generally, or for particular clients or on particular files, is correct or of a high or any particular standard.

The Institute expressly disclaims all liability for any loss or damage arising from any reliance upon the fact that the Institute conducts the Quality Review Program or has reviewed a particular member in the course of the Quality Review Program, or upon any annual reports, overviews, reports on particular members or practices, or other materials produced by the Institute regarding or in connection with the Quality Review Program.

All information is current as at August 2006

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Working together to bridge the quality gap

I am delighted to present this report on the Institute's Quality Review Program.

The program reflects the ongoing dedication of the Institute and Chartered Accountants in practice to do all they can to maintain the highest professional standards. It is also evidence of the Institute's commitment to work with regulators to achieve this.

There are two key roles for the program: to ensure members in practice comply with standards, and to assist members in doing so. Where serious non-compliance is found, the consequences can be significant.

This year 85 per cent of reviewed practices were either informed that no further action was required or informed that procedures were adequate, with only minor issues to address.

This is a pleasing result that suggests the vast majority of standards are being met in practices, but there is still room for improvement. The Institute has identified issues that require attention and has introduced a range of educational measures to help members address these issues.

This report provides a snapshot of what the program is doing to ensure practices are meeting standards. Naturally, feel free to contact the Institute if you would like to know more.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Graham Meyer', written in a cursive style.

Graham Meyer
Chief Executive Officer
The Institute of Chartered Accountants in Australia

Executive summary

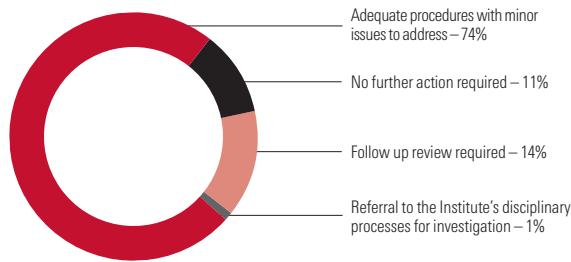
- > During the year to 30 June 2006, 482 reviews were completed. Of these, 29 were reviews of practices that audit publicly listed companies. The reviews included Big 4 practices and a number of mid-tier practices
- > As at 30 June 2006, another 543 practices were under review of which 41 audit publicly listed companies
- > During the year, the following reports were issued:
 - No further action required – 11 per cent
 - Adequate procedures with minor issues to address – 74 per cent
 - Follow up review required – 14 per cent
 - Referral to the Institute’s disciplinary processes for investigation – 1 per cent
- > In cases where improvement is required, quality reviewers regularly offer practical advice to help members address this. The Institute has also assisted members by updating and promoting a series of ‘technical snapshot’ guidance documents, and delivering a range of educational initiatives to help address independence issues arising from a small number of reviews
- > Feedback from members indicated that the program is both professionally run and well respected. Over 89 per cent of members surveyed believed the review enhances their quality control systems. More than 99 per cent agreed that the review was conducted in a professional manner
- > To assist members in adapting to new and updated quality control standards, the Institute has extensively revised its quality control guidance for practices. A new, interactive ‘Quality Control Guide’ will soon be available
- > A self-assessment process confirmed that the program met the standards outlined in the International Federation of Accountants’ (IFAC) statement of membership obligations (SMO 1: Quality Assurance)
- > The Quality Review Committee has conducted a strategic review of the Quality Review Program. As part of this, a study of similar programs in the US, the UK, New Zealand and Canada was undertaken. This confirmed that the program meets world best practice and also identified some potential enhancements. These are currently being evaluated
- > The Financial Reporting Council (FRC) has appointed a consultant to review the Quality Review Program. The Institute welcomes this review and values its relationship with all regulatory bodies
- > The Institute and the Audit Quality Review Board (AQRB) signed a ‘Memorandum of Understanding’ committing both bodies to work together in promoting a robust system of audit quality and auditor independence in Australia.

Results of the Quality Review Program

Summary

During the past 12 months, there have been some positive results from Quality Reviews, but there are also areas for improvement. Given the scale of recent changes to Australian standards and regulations, it has been a challenging time for members, which is why the Institute is continuously developing its education initiatives.

Overall, it is encouraging that 85 per cent of practices were either informed there was no further action required or informed that procedures were adequate, with only minor issues to address. Where breaches are identified the Institute monitors practices to ensure action is taken.



Key findings

- > The majority of practices reviewed had documented audit procedures as required by the relevant standards. This is an important area of focus for the program. Properly managed and documented audit procedures are vital if members are to do their job of protecting investors and the public. High quality audit procedures and documentation also help protect members in the event of legal challenge.
- > The vast majority of reviewed practices are meeting independence standards. Independence is critical to the objectivity required by the *Corporations Law*, the Institute's standards and the public's expectations. A small number of breaches were identified in the area of self-managed superannuation funds (SMSFs). For example, some members were auditing the fund of a partner in their practice or a fund of a close family member. To address this, the Institute has developed a new education guide, contained in a CD-ROM, that was recently mailed to over 5,000 registered company auditors and members who perform audits of SMSFs. Relevant Institute training seminars are also being promoted and conducted across Australia.
- > The role of the program is not only to ensure compliance with standards but it is also to identify where, as an Institute, additional training or guidance is required. This year's reviews were more rigorous than ever and identified some instances of the following:

Audit engagements

- No evidence of audit planning documentation, no documentation of internal controls or assessment of risks prior to the audit work being performed
- No subsequent events review and inadequate attention to areas such as going concern
- No engagement letters or similar documentation
- Inadequate documentation in instances where no significant threat to independence exists.

Compilation engagements

- Financial reports failing to specify they were Special Purpose Financial Reports
- Non-compliance with APS 9: Statement on Compilation of Financial Reports
- Minor errors in accounting treatment or disclosures.

One individual breach in relation to an engagement is not generally considered a major issue. However, if a number of breaches are identified in the same engagement, there is a higher degree of concern, and that can lead to a follow-up review or referral to the Institute's disciplinary processes for investigation.

Where minor breaches are identified, practices are given a set timeframe to address these. As experienced professionals, quality reviewers frequently offer suggestions to help practices do this.

Where more serious breaches are identified, practices are required to undertake a follow up review, or are referred for disciplinary proceedings.

In the year ending 30 June 2005, 56 practices required a follow up review. These follow up reviews either took place in the past twelve months or are in progress.

Response to results

- > To help members address some of the issues identified during reviews, the Institute has also produced a series of 'technical snapshot' guidance documents. These include:
 - 'ASA 210 Terms of Audit Engagements'
 - 'ASA 300 Planning an Audit of a Financial Report' and 'ASA 315 Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement'
 - 'ASA 560 Subsequent Events'
 - 'ASA 570 Going Concern'
 - 'APS 1 Conformity with Accounting Standards and UIG Consensus Views'
 - 'APS 9 Statement on Compilation of Financial Reports'.
- > Independence has also been a focus in the past 12 months. This has included:
 - Producing and updating a guide ('Independence Guide: Interpretations in a Co-regulatory Environment') that explains the Professional Independence requirements and gives practical examples of issues faced by accountants and auditors
 - Producing an 'Auditor Independence Checklist' identifying the relationships that may give rise to an independence issue
 - Regular commentary about independence in Charter, the Institute's magazine.
- > All the above initiatives have been promoted via the Institute's member communications program, and details are available from the Institute's website.

Achievements of the Quality Review Program

Activity

In the past 12 months 482 practices were reviewed. This included practices of all sizes, including mid-tier practices and the Big 4.

Each year the reviews for a number of practices are not completed, for reasons including:

- > A sole practitioner has retired, or will retire during the next six months
- > A review has recently been conducted by CPA Australia
- > The practice is the subject of an imminent merger
- > The member has resigned their membership from the Institute.

Member feedback

The Quality Review Program works alongside regulators to enforce standards and also enjoys a good working relationship with members. Evidence of this can be seen in the member feedback survey conducted after a review has taken place.

In the past 12 months, the surveys have shown that:

- > More than 89 per cent of practices say the program enhances their quality control systems
- > Almost all practices (99 per cent) agree reviews are conducted in a professional manner
- > More than 86 per cent agreed that their practice 'benefited from the review'.

These results are a testament to the professionalism and efficiency of the reviewers and also reflect a genuine commitment from practices to continually improve their work.

APES 320: Statement of Quality Control for Firms

In July 2005, the Institute and CPA Australia jointly adopted the revised 'APS 5: Statement of Quality Control for Firms' in order to meet the International Standard of Quality Control 1 (ISQC 1) laid down by the International Auditing and Assurance Standards Board. In June 2006, the Accounting Professional and Ethical Standards Board revised and reissued APS 5, as well as renaming the standard APES 320: Statement of Quality Control for Firms.

In essence, APES 320 details more comprehensive policies and procedures for all practice areas. It also makes documentation of quality control procedures more important.

To enable a smooth transition to this standard (particularly for smaller practices), the Institute is working with members as they implement APES 320. The Institute has extensively revised and updated its guidance on quality control and will soon issue this in the form of a comprehensive, interactive 'Quality Control Guide'. The guide can be tailored to individual practices, helping members to meet the new obligations.

The Audit Quality Review Board

The Audit Quality Review Board (AQRB) was launched to enhance the credibility and integrity of the Australian auditing framework. Aiming for continual improvement in the audit profession, it monitors practices that audit publicly listed companies (currently the Big 4) to assess whether they comply with professional standards and the law.

In June 2006, the Institute and the AQRB signed a 'Memorandum of Understanding' committing both bodies to work together in promoting a robust system of audit quality and auditor independence in Australia. As part of this agreement, both bodies agreed to share information (where appropriate), consult regularly and promote discussion on issues such as quality control and independence in the auditing of publicly listed companies.

Strategic review

The Quality Review Committee conducted a strategic review of the Quality Review Program. This included a detailed comparison with similar programs in the US, the UK, New Zealand and Canada. It found that the Institute's program meets or exceeds international best practice in areas such as selection, frequency and content. The comparison identified areas that could potentially enhance the program. These are now being considered by the Quality Review Committee.

International standards

The program has enjoyed further international endorsement this year through the International Federation of Accountants (IFAC). The IFAC statement of membership obligations (SMO 1) was effective from December 2005, requiring the program to undertake a detailed self-assessment of its procedures and policies. This confirmed that the program meets rigorous IFAC criteria and therefore world best practice.

Financial Reporting Council review

As part of its regulatory role, the Financial Reporting Council has appointed a consultant to review the Quality Review Program. The Institute is strongly committed to co-regulation and to continually improving its program. The review is seen as a further opportunity to do this.

Priorities for 2006/2007

The Quality Review Committee has identified a number of priorities for 2006/2007:

- > A further 600 practices will be selected for review. As always, this will include a mix of different size practices
- > The committee will monitor the implementation of APES 320 (formerly known as APS 5) by practices. Quality reviewers will undergo additional training to reflect changes in standards, to ensure they can assess and guide members appropriately. The Quality Control Guide will shortly be available, free to members, via the Institute website. It will be actively promoted in the Institute's print and electronic member communications, and also endorsed by quality reviewers while they are conducting reviews
- > The Committee will assess potential enhancements to the program (identified in the strategic review), and begin implementation where appropriate
- > The Institute will remain committed to both consultation and co-regulation. The program will continue to involve regulators (such as the Australian Securities and Investment Commission and the Australian Taxation Office), other stakeholders (such as the AQRB) and international accounting and standards bodies (such as IFAC) to help ensure compliance with standards.

Background

Why have a Quality Review Program?

The Quality Review Program is an integral part of the profession's responsibilities to the public. Enforcing compliance helps ensure members maintain the highest standards. By staying in close touch with practices, the program identifies areas that require additional training or technical support.

Who is reviewed?

All practices that audit publicly listed companies are reviewed every three years. All other practices are reviewed every five years. Due to the cost and administrative burden involved in a full review, practices that earn gross annual fees of less than \$50,000 undergo a limited review process that focuses on compliance with professional indemnity insurance, trust account and continuing professional education regulations. However, any practices that perform audits requiring a registered company auditor must undergo a full review regardless of fees.

Selection for a first review is random, with subsequent reviews conducted every three or five years.

How does the process work?

A quality review assesses the quality control policies and procedures in an accounting practice, using a program developed by the Institute. The reviewer:

- > Examines manuals, working papers and other documents to ensure adherence to professional standards and regulatory and legal requirements
- > Selects a cross-section of current engagement files to assess whether quality control procedures are being implemented.

Reviewers are experienced Chartered Accountants selected by the Institute for their professional reputation and practice experience. They are appointed by the Institute with the consent of the practice. The costs of the review are met by the practice based on an hourly-rate formula that varies according to the size of the practice. During the year, the Institute's revenue from reviews was \$1,195,000. Total costs, including payments to reviewers, were \$1,479,000.

Review outcomes

A practice receives two reports as a result of the review:

- > The reviewer's **findings and suggestions report** to the practice contains information on any breaches of mandatory professional standards identified. Reviewers are also encouraged to include best practice suggestions to help the practice improve policies and procedures. Practitioners are encouraged to comment on this report before it is submitted to the Institute with the reviewer's work papers
- > The **formal report** to the practice from the Institute includes the Institute's assessment of the practice and identifies any follow-up action required. Breaches of professional standards are included in this report. The Institute's assessment is based on the reviewer's recommendation.

The Institute's assessment

The Institute's formal report falls into one of four categories:

- > **No further action required** – the practice's quality control procedures appear adequate to comply with professional standards
- > **Adequate procedures with minor issues to address** – the quality control policies and procedures appear substantially adequate to comply with professional standards and legal requirements, with policies and/or procedures generally adhered to
- > **Follow up review required** – a practice's quality control policies and procedures appear insufficient to comply with professional standards and legal requirements, and/or existing policies and/or procedures have not been adhered to. An action plan must be prepared by the practice, a follow-up review must take place within one year which may lead to referral to the Institute's disciplinary process for investigation
- > **Referral to the Institute's disciplinary processes for investigation** – any review that reveals a fundamental breach of standards is automatically referred to the Institute's disciplinary processes for investigation.

A reviewer may also recommend a referral for investigation where there appears to be a fundamental deficiency in the procedures or ethical behaviour of a practitioner or practice.

Sanctions

A member's Certificate of Public Practice (CPP) may be suspended by the Institute board for:

- > Not co-operating with the review program in accordance with Regulation 710, and/or
- > Not responding to correspondence as requested.

During the year under review, 3 CPPs were suspended. This represents less than 1 per cent of all reviews. Suspension prevents members from continuing to practice as Chartered Accountants.

Governance

The Quality Review Committee oversees the Quality Review Program and advises the Institute on strategic direction. As well as some non-members, the committee includes quality reviewers and members from a cross-section of public practices, varying in size, specialisation and geographical location. The committee members are:

Graeme Sampson FCA

Chairman of the committee since 2001 and a committee member since 1995. Graeme is a director of Bentleys MRI Perth Pty Ltd where he provides business and tax advice to clients, especially in the wine and construction industries.

Dr Max Bessell CA

Max has recently joined the University of Adelaide after eight years at the University of South Australia. He joined the committee in 2003 and has worked in legal and chartered accounting practices. His roles at the University of South Australia included managing an international quality accreditation process and working on the development of MBA and undergraduate accounting degrees.

Michael Burgess FCA

Michael was a founding member of the committee. He is an adjunct professor of the Business School at the University of South Australia and a director of Chapel Hill Wines, Angas Securities, Royal Flying Doctor Service of Australia, Medical Insurance Australia and Adelaide Entertainment Centre. He is also a Commissioner in the Legal Services Commission of SA. Michael retired as a partner from KPMG in 2001.

David Hill

David joined the committee in 2003. He is a retired partner of Minter Ellison, and is now Special Counsel with Kennedys. He has been primarily involved in commercial litigation and dispute resolution and has provided legal services to the Institute, including assistance in setting up the program.

Liane Ringham

Liane joined the committee in 2004. She is the managing director and owner of INSIDE STORY Knowledge Management Pty Limited, a research-based consultancy advising Australian companies on branding and marketing.

Michael Stibbard FCA CFP

Michael has been a member of the committee since 1999. He is chairman of Horwath (NSW) Pty Limited, managing director of Horwath Australia Limited and member of the Horwath International Board. He has extensive experience in external assurance services, taxation and corporate advisory.

Stephen Thom FCA

Stephen joined the committee in 1997. Currently a sole practitioner, his areas of experience include auditing, business services, taxation, forensic accounting, valuation and management consulting. Stephen is also a reviewer for the program.

Committee member	Committee meetings	
	Attended	Held
Graeme Sampson FCA (Chairman)	3	3
Dr Max Bessell CA (Academic)	3	3
Michael Burgess FCA (Retired practitioner)	3	3
David Hill (Legal representative)	3	3
Liane Ringham (Business owner)	2	3
Michael Stibbard FCA CFP (Practitioner)	3	3
Stephen Thom FCA (Reviewer and sole practitioner)	2	3

Glossary of abbreviations

Abbreviations or acronyms	Name	Website (where applicable)
The Institute	The Institute of Chartered Accountants in Australia	www.charteredaccountants.com.au
The program	Quality Review Program	
The committee	Quality Review Committee	
ASIC	Australian Securities and Investment Commission	www.asic.gov.au
ATO	Australian Taxation Office	www.ato.gov.au
AQRB	Audit Quality Review Board	www.aqrb.org.au
FRC	Financial Reporting Council	www.frc.gov.au
IFAC	International Federation of Accountants	www.ifac.org
APESB	Accounting Professional and Ethical Standards Board	www.apesb.org.au
SMO	Statement of membership obligations	
SMSFs	Self-managed superannuation funds	

The Institute of Chartered Accountants in Australia

National / New South Wales

Chartered Accountants House
Level 14, 37 York Street
Sydney NSW 2000
GPO Box 3921
Sydney NSW 2001
Ph: 02 9290 1344
or 1300 137 322
Fax: 02 9262 1512

Australian Capital Territory

National Surveyors House
27-29 Napier Close
Deakin ACT 2600
GPO Box 396
Canberra ACT 2601
Ph: 02 6282 9600
or 1300 137 322
Fax: 02 6282 9800

Queensland

Level 1, 200 Mary Street
Brisbane QLD 4000
GPO Box 2054
Brisbane QLD 4001
Ph: 07 3233 6500
Fax: 07 3221 0856

South Australia / Northern Territory

Level 11
1 King William Street
Adelaide SA 5000
Ph: 08 8113 5500
or 1800 645 947
Fax: 08 8231 1982

Victoria / Tasmania

Level 3, 600 Bourke Street
Melbourne VIC 3000
GPO Box 1742
Melbourne VIC 3001
Ph: 03 9641 7400
Fax: 03 9670 3143

Western Australia

Ground Floor BGC Centre
28 The Esplanade
Perth WA 6000
PO Box Z5385
St Georges Terrace
Perth WA 6831
Ph: 08 9420 0400
Fax: 08 9321 5141

