Quality Review Report 2012
The Institute is the professional body for Chartered Accountants in Australia and members operating throughout the world.

Representing more than 70,000 current and future professionals and business leaders, the Institute has a pivotal role in upholding financial integrity in society. Members strive to uphold the profession’s commitment to ethics and quality in everything they do, alongside an unwavering dedication to act in the public interest.

Chartered Accountants hold diverse positions across the business community, as well as in professional services, government, not-for-profit, education and academia. The leadership and business acumen of members underpin the Institute’s deep knowledge base in a broad range of policy areas impacting the Australian economy and domestic and international capital markets.

The Institute of Chartered Accountants Australia was established by Royal Charter in 1928 and today has around 60,000 members and more than 12,000 talented graduates working and undertaking the Chartered Accountants Program.

The Institute is a founding member of the Global Accounting Alliance (GAA), which is an international coalition of accounting bodies and an 800,000-strong network of professionals and leaders worldwide.

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President’s foreword

The Institute has a mandate to govern the high standards of the Chartered Accounting profession. We undertake this responsibility within the co-regulatory framework in Australia, which also comprises regulators and standard-setters. Since the Institute was established by Royal Charter in 1928, we have remained committed to leading the profession in accordance with our motto, *without fear or favour*. The motto also refers to our unwavering commitment to act in the public interest and support the sustainability of the profession and business.

Our Quality Review Program (the Program) is an important component of our professional compliance framework, which is designed to ensure members uphold the high educational, professional and technical standards expected of Chartered Accountants and demanded by stakeholders, clients and broader society.

This Quality Review Report 2012 is part of our suite of annual reporting on the Institute’s performance and member support programs. The report summarises the results of the Program for the past financial year, based on quality reviews of practices ranging in size from national partnerships to sole practitioners. In the interests of transparency and confidentiality, we report only aggregated data, trends and issues arising from the findings.

This past year saw the launch of a new, innovative model of reviewing the audit practices of major firms using an online survey. The Institute has analysed the survey results and provided in-depth feedback on the drivers of audit quality in each firm. The results also gave the Institute valuable insight into where to target resources to enhance audit quality for all Chartered Accountant auditors.

We have also enhanced the Program by implementing specialist reviews for insolvency practices, and planning is underway to review financial advisory services. In implementing these new approaches, we remain focused on our objective of adding value to reviews and retaining our relevance to an evolving profession.

I would like to acknowledge the Quality Review Committee and the dedication of the Program reviewers. Their professionalism in reviewing practices *without fear or favour*, while offering technical and peer support is central to the success of the Program. This approach is also imperative to maintain the trust and confidence of members and their clients, regulators and other stakeholders, and assists us in upholding financial integrity in society.

Craig Farrow FCA
President
Institute of Chartered Accountants Australia
Executive summary

Protecting the CA brand through a robust quality review process
The Institute’s Quality Review Program (the Program) assesses whether our practitioner members have implemented appropriate quality control policies and procedures in their practices. By identifying areas where these policies and procedures are not appropriate to maintain compliance with standards and legal requirements, we work with individual practices to remediate problem areas. Importantly, we also use the knowledge gained from this process to promote continuous improvement throughout the accounting profession.

Overall results from quality reviews conducted during 2011–2012 declined marginally compared with 2010–2011 results. The majority of practices (76%) were reported to have either met all of the professional standards and regulatory requirements as set by standard-setters and regulators or showed levels of non-compliance that were not regarded as serious. This compares with 78% of practices in the 2010–2011 financial year. Although these results leave room for improvement, they need to be considered against a backdrop of:

- Continuing to move the Program from an educational focus to a compliance-based approach, resulting in some issues that were initially regarded as minor, now regarded as significant
- The increasing number and complexity of standards and other regulatory requirements since the Program commenced
- Challenges of ongoing global economic uncertainty and natural disasters in recent years.

Evolving the Program
This year saw the launch of our innovative review approach for the audit practices of major firms, starting with Deloitte, Ernst & Young, KPMG, PwC and Grant Thornton. Using an online quantitative survey, we assessed the perceptions of various respondent groups (partners, managers, qualified staff and graduates) on the firms’ commitment to the drivers of audit quality. There was a high degree of consistency among respondent groups in relation to a strong commitment to audit quality, and in particular the need for audit scepticism.

During the year we also enhanced the Program by implementing specialist reviews for insolvency practices. In the coming financial year we anticipate launching our tailored reviews for financial advisory services. In implementing these new approaches, we remain focussed on the fundamental objectives of adding value to reviews while minimising duplication and retaining our relevance to a changing profession.

Fulfilling our co-regulatory role
The Program’s role in fulfilling the Institute’s obligations to the International Federation of Accountants (IFAC), the Financial Reporting Council (FRC) and the Professional Standards Council, in particular, continued this year and we have also been liaising closely with the Australian Securities and Investments Commission (ASIC).

Providing assistance, resources and tools
The Program continued its role of supporting members through providing direct assistance during quality reviews, and informing the Institute’s development of resources and tools. Of particular note this year was the presentation of a number of specific training sessions highlighting ‘Top 10’ issues arising from quality reviews.

Disseminating information
A cornerstone of the Program since its inception has been transparent and timely communication of Program-related issues to members and other stakeholders. This report is a key aspect of this communication. We have also added a number of channels to our communications:

- A practical checklist based on the key results reported in last year’s Quality Review Annual Report, including guidance on the issues and links to Institute tools to assist practitioners in monitoring their own practices
- Additional guidance for practitioners on self-review/practice monitoring provided via a dedicated page on the Institute website
- More timely communications to alert members to issues as they arise during the year.

Professionalism underpins Program
Dedicated and professional reviewers are central to the effectiveness of our Program. The reviewers add value to the Program far beyond the review process by visiting practices as peers. Their practical experience is invaluable to many members who have been reviewed.
The year in review

### Quality Review Program:
Key achievements 2011 – 2012

<table>
<thead>
<tr>
<th>Protecting the CA brand through a robust quality review process</th>
<th>Evolving the Program</th>
<th>Fulfilling role in co-regulatory framework</th>
<th>Providing assistance, resources, tools for members</th>
<th>Disseminating information</th>
<th>Professionalism underpins Program</th>
</tr>
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<tbody>
<tr>
<td>• 412 practices reviewed</td>
<td>• Implemented an innovative review process for major firms</td>
<td>• Compliance with IFAC requirements</td>
<td>• Checklist of lessons from quality review</td>
<td>• Quality Review Report</td>
<td>• Dedicated pool of CA reviewers providing face-to-face peer reviews</td>
</tr>
<tr>
<td>• Review results demonstrate robustness compared to other accounting bodies and overseas jurisdictions</td>
<td>• Enhancing review process by: – Implementing a tailored review process for insolvency services</td>
<td>• Collaboration with key stakeholders, including regulators (FRC and ASIC)</td>
<td>• T&amp;D ‘Top 10’ issues</td>
<td>• Newsletters</td>
<td>• Positive feedback from practitioners</td>
</tr>
<tr>
<td>• Remediation by practices improves quality</td>
<td>– Developing a tailored review process for financial advisory services</td>
<td>• Informs other Institute assistance/tools (Appendix 3)</td>
<td>• Conferences</td>
<td>• Website</td>
<td>• New specialist audit and insolvency reviewers accredited</td>
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Quality review results 2011 – 2012

Quality review results have been divided into two sections, based on the two types of reviews conducted in 2011 – 2012:

- Reviews of the audit practices of the major firms
- Other practice reviews.

The key focus of the Program in the financial year was the review of audit practices of five major firms. Institute reviews of the major firms have recommenced as a consequence of the Audit Quality Review Board (AQRB) completing its mandate in 2009. The reviews of other practices included 1,843 engagement file reviews in 407 practices. This total of 412 practices reviewed during the year reflects a consistent level of activity compared to 432 practice reviews in the 2010 – 2011 year, and 456 in 2009 – 2010, especially given the Program did not conduct major firm reviews in these years.

Audit practices of major firms

This year saw the launch of our innovative review approach for the audit practices of major firms, starting with Deloitte, Ernst & Young, KPMG, PwC and Grant Thornton. This approach was foreshadowed in our 2010 thought leadership paper Quality Review: past, present and future. Using an online quantitative audit quality survey we assessed the perceptions of various respondent groups (partners, managers, qualified staff and graduates) on the firms’ commitment to the drivers of audit quality.

For the compliance aspect of the reviews, rather than conducting file reviews we relied on ASIC’s Audit Inspection Program and the firms’ national and international reviews, together with examining any remedial action taken by the firms. We will assess whether this approach can be adapted for other practice areas within the firms, based on a risk assessment of the type of work undertaken and the extent of other internal and external reviews of the firm.

Enhancing rather than duplicating ASIC inspections adds value for practices by analysing audit quality in-depth and improves efficiency by avoiding duplication of ASIC and other reviews. Ultimately this will enhance audit quality throughout the profession, which is a fundamental objective of our commitment to the public interest.

Outcomes of the surveys

Partners, managers and qualified staff responded to questions on all drivers of audit quality, whereas graduates responded to questions on skills and competencies only. A total of 1,702 partners and staff responded to the survey from the five firms from 5,050 invitations to participate. From the responses we compiled a benchmark report detailing the results by firm. By sharing with the firms benchmark data about their responsiveness to the drivers of audit quality, we provided firms with insights into the effectiveness of their quality systems, assisting them to promote internal attitudes towards audit quality.

Key messages

There was a high degree of consistency among respondent groups in relation to a strong commitment to audit quality, and in particular the need for audit scepticism. This was reinforced by the belief among respondents that quality is an important component of partner remuneration and staff assessment.

An in-depth analysis of the survey responses to the different drivers of audit quality, and components of each driver, revealed there were some aspects of audit quality that were extremely strong, and other areas that provide opportunities for enhancement. Technical aspects of audit were consistently strongly evident, including audit methodologies. Communication skills were regarded as fundamental to audit quality and staff indicated a desire for further development in this area, together with enhanced coaching and mentoring within the firm. Common across all five firms was a much higher assessment of effective communication by audit partners than by managers and qualified staff. The challenge of balancing commercial pressures with audit quality was also a common theme. We will continue to work with the firms in relation to these survey findings.

‘We appreciate the effort made by the Institute to provide insights into the attitudes of our people to audit quality and to provide benchmarks against the results from other firms.’

Denis Thorn CA, Partner, Ernst & Young
Key messages within each driver of audit quality are summarised in the table below.

<table>
<thead>
<tr>
<th>Culture of audit quality in the firm</th>
<th>Strong agreement that the firm instils a culture of quality through its management practice and the ‘tone at the top’ across all respondent groups and firms.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skills and competencies</td>
<td>All respondent groups rated ‘professional scepticism’ as one of the top three skills and competencies required by auditors. Communication skills were also consistently identified as a driver of audit quality.</td>
</tr>
<tr>
<td>Effectiveness of the audit process</td>
<td>There was general agreement across all respondent groups and firms that a risk based approach was taken and documented, the engagement partner and manager are closely involved in the audit approach for all audit engagements and the firm’s audit methodology is ‘user-friendly’.</td>
</tr>
<tr>
<td>Factors outside the control of auditors</td>
<td>There was general support for the concept that clients were co-operative and supported a quality audit.</td>
</tr>
<tr>
<td>Commitment to audit quality</td>
<td>There was a uniform belief across partners, managers and qualified staff in all five participating firms that the firms are committed to audit quality.</td>
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</table>

Where to now?

- The five firms who participated in this approach commended the Institute on the value of the survey in providing an in-depth analysis of the underlying elements of the drivers of audit quality within their firms. These firms have undertaken to draw on the results for their particular firm to enhance any aspects that could be improved. We will work with the firms to correlate findings from the survey with issues arising from their internal review program and ASIC inspection.
- The Institute will use the findings to inform our activities including the Chartered Accountants Program and training and development.
- The value of this survey approach is apparent, and based on its success we are assessing how we can apply this approach to other aspects of quality reviews, in particular:
  - Other firms subject to ASIC inspections who have comprehensive internal review programs
  - Non-audit areas of the major firms.

Other practice reviews

Overall results from quality reviews conducted during 2011 – 2012 declined slightly compared with 2010 – 2011 results. The great majority of practices (76%) were reported to have either met all of the professional standards and regulatory requirements as set by standard-setters and regulators or showed levels of non-compliance that were not regarded as serious. This compares with 78% of practices in the 2010 – 2011 financial year.

The Institute takes the view that non-compliance is preventable and works in three key ways to promote continuous improvement:

- Working closely with members to remediate their policies and procedures
- Analysing review results in detail to direct Institute resources and services where they are most needed
- Using the results and issues arising from the Program to inform our advocacy with regulators and standard-setters.
Each practice that is reviewed is issued with one of four types of review results letters, as explained on page 21. The following results letters were issued in the year ended 30 June 2012:

**Review results**

<table>
<thead>
<tr>
<th>Year</th>
<th>No departures from professional standards</th>
<th>Departure(s) from professional standards, not classified as serious</th>
<th>Follow-up review required</th>
<th>Referral to the Institute’s disciplinary processes for investigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>11/12</td>
<td>6%</td>
<td>70%</td>
<td>24%</td>
<td></td>
</tr>
<tr>
<td>10/11</td>
<td>5%</td>
<td>73%</td>
<td>22%</td>
<td></td>
</tr>
<tr>
<td>09/10</td>
<td>6%</td>
<td>74%</td>
<td>19.5%</td>
<td>0.5%</td>
</tr>
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</table>

Note: These figures are presented as a percentage, as the total number of reviews varies from year-to-year.

Practices requiring a follow-up review predominantly fell into one, or both, of the following categories:

- Practice had not documented its quality control policies and procedures
- One or more audit reports were not supported by sufficient, appropriate documented audit evidence.

Some practices did not fall into either of these categories; however the reviewer was of the opinion that overall one or more engagements were not conducted in accordance with professional standards and therefore a follow-up review was necessary.

**Common non-compliance issues**

Having established top-line figures, we look deeper into the review results to establish any patterns of non-compliance. The number and significance of non-compliance issues, and the level of remediation, has increased slightly over recent years.

Members reviewed in the 2011–2012 financial year were last reviewed three, and in many cases, five years ago. The intervening period has been a time of economic uncertainty for members and their clients and natural disasters in many regions, coupled with significant increases in standards and the professionalism expected of members. That quality review results have not significantly declined in this time is testament to our members’ commitment to quality in their practices. This also demonstrates the Program, together with other Institute activities to improve the standards of professional work, is achieving its objective.

In the section below we break down common non-compliance issues into categories.

**Quality control policies and procedures throughout the practice**

Most practices have adapted to the requirement to maintain documented quality control policies and procedures and the results for the current year indicate this trend is continuing. Some practices need to refine their systems by improving aspects of this documentation. To assist members the Institute has published a *Quality Control Guide*, providing sample policies and procedures that members can use in applying all the components of quality specified in the standards APES 320: Quality Control for Firms and ASQC 1: Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements.
Training and development

Quality reviews revealed a shortfall in some practitioner members meeting requirements surrounding minimum required hours of training and development in accordance with R7: Regulations Relating to Training and Development. This was mainly in respect of their statutory registrations. Members are required to complete a minimum of 120 hours of training and development on a three year basis. As part of their training and development hours, they must complete 40% of their hours in each of their specialist areas. SMSF auditors must dedicate at least 30 hours of their training and development to professional development activity relevant to auditing SMSFs each three-year period. The Institute endeavours to supply sufficient opportunities for a member to undertake adequate and appropriate training and development activities. An Institute initiative is LiveOne, interactive online training, accessible by members from any location.

When a shortfall in hours has been identified, the Institute contacts the member to ensure the shortfall is addressed. A member may be excluded from membership of the Institute if they fail to meet their training and development requirements for two consecutive years.

Non-compliance with APES 320 and ASQC 1

<table>
<thead>
<tr>
<th>% of practices</th>
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<tbody>
<tr>
<td>10/11</td>
</tr>
<tr>
<td>11/12</td>
</tr>
<tr>
<td>23%</td>
</tr>
<tr>
<td>30%</td>
</tr>
<tr>
<td>18%</td>
</tr>
<tr>
<td>18%</td>
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Non-compliance with R7

<table>
<thead>
<tr>
<th>% of practices</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/11</td>
</tr>
<tr>
<td>11/12</td>
</tr>
<tr>
<td>5%</td>
</tr>
<tr>
<td>5%</td>
</tr>
<tr>
<td>9%</td>
</tr>
<tr>
<td>3%</td>
</tr>
<tr>
<td>8%</td>
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<tr>
<td>4%</td>
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<td>4%</td>
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Audit
The 2011 – 2012 financial year has been challenging for auditors:

- Audit quality is again under the spotlight as auditors are regarded as a key gatekeeper in uncertain capital markets
- The AUASB’s new suite of auditing standards, based on the IAASB’s Clarity standards, came into effect for the audit of financial periods starting on or after 1 January 2010, with increased requirements for auditors.

Although overall compliance with the auditing standards remains consistent, based on the results for the financial year our main concern continues to be a lack of documented audit evidence. The review of a small number of practices revealed insufficient documented evidence supporting the audit opinion. More commonly, there was insufficient documented evidence as required by the auditing standards to support a particular audit area. The most common areas where compliance was not supported by sufficient documented audit evidence are listed in the bar charts on the following pages.

In many instances where there was a lack of documentation, the member said adequate audit work had been completed, but not all had been documented. The Institute takes the view that if the work is not documented, it does not constitute audit evidence. Documentation is critical as:

- It provides evidence that the audit was adequately performed in accordance with Australian auditing standards
- It provides a record of the basis for conclusions, including the auditor’s report
- It is mandatory under the legally-enforceable Australian auditing standards.

Under the standards, the test of sufficient documentation is whether another auditor, with no prior knowledge of the engagement, can review and evaluate the audit and understand how the conclusions were reached. At the end of reviewing an audit engagement, the reviewer assesses whether there is any indication that the audit opinion was not based on sufficiently documented and appropriate audit evidence.

During the year we continued to see a trend of members either specialising in audit or resigning from all audit engagements as members recognise that auditing is an increasingly advanced technical skill. This reflects the increasing complexity and regulation of audit, requiring a significant investment of practice resources to maintain audit competence.

Quality reviews are an important mechanism to help practitioners decide whether they are competent and adequately equipped to perform audits. The Institute assists practitioners who wish to specialise in audit in a number of ways (see page 31).

Basis of audit findings
These results came from the review of audit engagement files constituting audits of a range of entities:

- Public listed entity
- Non-listed public company (including company limited by guarantee)
- Large proprietary company
- Small proprietary company
- SMSFs
- Incorporated association
- Non-corporate disclosing entity
- Other unincorporated body
- Solicitor’s trust account
- Real estate agent trust account
- Other.
Non-compliance with auditing standards

ASA 230: Audit Documentation and ASA 500: Audit Evidence
- Audit documentation exists but does not constitute sufficient audit evidence to support the audit opinion
  
  11/12  16%
  10/11  13%

ASA 210: Agreeing the Terms of Audit Engagements
- Engagement letter does not contain all required information
- Recurring audit: need for revised engagement letter not assessed
- Auditor did not establish preconditions for audit
  
  11/12  25%
  10/11  16%

ASA 220: Quality Control for Audits of Historical Financial Information
- No evidence regarding compliance with independence requirements
- Workpapers don’t show evidence of engagement partner review
  
  11/12  27%
  10/11  31%

ASA 240: The Auditor’s Responsibilities Relating to Fraud in an Audit of a Financial Report
- No enquiries made with regard to fraud
- Engagement team did not discuss risk of material misstatement, including from fraud and related parties
  
  11/12  30%
  10/11  25%

ASA 300: Planning an Audit of a Financial Report
- Audit strategy not documented
- Inadequate audit strategy
- Audit plan not documented
- Inadequate audit plan
  
  11/12  18%
  10/11  17%

ASA 315: Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement and ASA 520: Analytical Procedures
- No analytical review performed as risk assessment
- No documentation of internal control
- No analytical review performed prior to forming an opinion on the financial reports
  
  11/12  49%
  10/11  58%

ASA 560: Subsequent Events
- No subsequent events review
  
  11/12  22%
  10/11  25%
ASA 210: Agreeing the Terms of Audit Engagements

- Auditor did not establish preconditions for audit

ASA 320: Materiality in Planning and Performing an Audit

- No materiality for financial report as a whole and no performance materiality

ASA 240: The Auditor’s Responsibilities Relating to Fraud in an Audit of a Financial Report

- No presumption of risk of material misstatement due to fraud in revenue recognition

ASA 800: Special Considerations—Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks

- Audit report for a special purpose financial report did not include emphasis of matter

Indicative results under Clarity standards

These audit issues arise from the review of audits conducted under both the old auditing standards and the Clarity standards. A more detailed analysis of preliminary results under the Clarity standards is included below. For most audit engagements, Clarity standards first applied to audits of financial periods ending 30 June 2011. A number of the audit engagements reviewed during the 2011–2012 financial year, particularly in the second half, were conducted under the Clarity standards. The vast majority of practices have adapted well to the Clarity standards. However, reviews indicate some practices still need to ensure their audit methodology has been revised to reflect the new and amended requirements in the Clarity standards. The list below highlights key areas practices need to focus on.

Non-compliance with auditor independence requirements

APES 110: Code of Ethics for Professional Accountants

- No documentation or inadequate documentation when considering threats to independence
- Appropriate safeguards were not adequately applied when carrying out audit and accounting functions for a client
- Auditing the SMSF of a partner in their practice
Other practice areas
We found compliance with standards governing practice areas, other than audit, was consistent with the prior year but still revealed areas of weakness. Close analysis of the results revealed this was where new standards have been introduced, such as those outlined below, and practices are taking a while to adjust to the changes. We have taken these results on board by being more proactive in alerting members to change and providing tools to assist members in the transition to these new standards.

Non-compliance with other standards

APES 205: Conformity with Accounting Standards

- Financial reports do not clearly state that they are special purpose
  
  | % of practices |
  |---|---|
  | 11/12 | 8% |
  | 10/11 | 19% |

- Special purpose financial reports did not clearly identify significant accounting policies
  
  | % of practices |
  |---|---|
  | 11/12 | 7% |
  | 10/11 | 19% |

APES 305: Terms of Engagement

APES 315: Compilation of Financial Information

- Compilation reports not in accordance with APES 315
  
  | % of practices |
  |---|---|
  | 11/12 | 26% |
  | 10/11 | 39% |

- Financial reports do not always clearly state that the financial information has not been audited
  
  | % of practices |
  |---|---|
  | 11/12 | 14% |
  | 10/11 | 26% |

- No acknowledgement was obtained from the client of their responsibility for the reliability, accuracy and completeness of accounting records and disclosure of all relevant information
  
  | % of practices |
  |---|---|
  | 11/12 | 30% |
  | 10/11 | 48% |

APES 220: Taxation Services

- The client was not provided with a statement in writing that the client is responsible for the accuracy and completeness of the information they provide
  
  | % of practices |
  |---|---|
  | 11/12 | 50% |
  | 10/11 | 48% |
We also analyse review results by considering the different types of services provided by practices. This assists us to identify the types of practices and services with a higher risk of non-compliance with requirements.

Audit services are governed by an exhaustive set of standards when compared with those for, say, compilation or tax engagements. Therefore, reviews of practices that conduct audits focus strongly in this area, and we have identified audit services as a high-risk area during a review. Our analysis indicates audits undertaken under the Corporations Act (2001), tend to have a higher level of non-compliance; typically these are larger, more complex audits subject to a wider range of auditing requirements. Within this framework the level of non-compliance slightly increased in relation to significant non-compliance issues.

The charts below indicate the results for practices conducting different types of engagements. The results for each practice type include all the engagements reviewed for those practices – for example for practices that undertake audits under the Corporations Act, the results include all Corporations Act and other audits, as well as other engagements conducted by the practice.

Practices that provide certain services

Practices that undertake audits under the Corporations Act, other types of audit and other services

Practices that undertake other types of audit and other services

Practices that undertake other (non-audit) services
Practices reviewed according to size

The proportion of practices reviewed in each size category reflects the approximate distribution of practices by size across the Institute as a whole. The only exception is for the Big 4 firms (Deloitte, Ernst & Young, KPMG and PwC) as the audit practices of these firms were all reviewed this year.
About the Institute’s Quality Review Program

As outlined in the Executive summary, the Program’s role is to assess whether our practitioner members have implemented appropriate quality control policies and procedures in their practice. We regard policies and procedures as appropriate when they are designed and implemented on engagements, so our practitioner members and their staff consistently comply with standards and regulatory requirements throughout their practice. We work with practices to remediate areas of non-compliance identified during their review. Importantly, we also use the knowledge gained from the Program to promote continuous improvement throughout the accounting profession.

Undergoing a quality review and remediating policies and procedures, where required, is compulsory for all practising Chartered Accountants.

In the interests of transparency, we report our findings to our members, regulators, standard-setters and the general public. While individual practices are not identified in this report, the trends, issues and results of reviews are summarised as the basis of the findings.

Integral to co-regulatory recognition

The Australian accounting profession exists within a co-regulatory environment (see Appendix 1). This means the Institute works with other bodies in Australia and internationally to regulate and govern the work of Chartered Accountants.

The Program is an integral part of this co-regulatory environment, maintaining quality within the profession and retaining the Institute’s position as a leading professional accounting body. Here are some of the key ways we are doing this.

- Ongoing liaison with regulatory bodies including ASIC and the ATO. For example, under the current regime approved auditors of SMSFs are subject to ‘an approved auditor compliance program’ under the auspices of the ATO. The ATO has regard to the competency requirements and professional obligations imposed by the Institute on its members, including quality reviews and auditing and independence standards.

- Quality assurance is a compulsory obligation of full membership of IFAC, which enables Institute members to benefit from the Institute being classified under legislation, such as the Corporations Act, as a ‘professional accounting body’. IFAC’s Statements of Membership Obligations (SMO) 1: Quality Assurance requires the Institute to conduct quality reviews of auditors of listed entities as a minimum, and to report annually on these reviews.

IFAC has recently proposed extending SMO 1 to require reviews of all auditors of financial statements, and recommends quality reviews of all practice areas. The Institute supports these proposals in the public interest. In our response, we highlighted the need for reviews to be appropriate to the type of practice under review, in particular where audits are conducted by sole practitioners running micro-practices. These auditors are currently eligible for a self-assessment review under the Institute’s Quality Review Program.

- Monitoring auditor independence on behalf of the FRC. The FRC is a statutory body established under the ASIC Act (2001). Among other activities it has responsibility for the effectiveness of the auditor independence regime in Australia. Rather than monitoring individual practices, the FRC relies on the reviews of the professional accounting bodies to fulfil this responsibility. Therefore, the Institute monitors and reports on auditor independence as part of the review program.

- Conducting the Program satisfies one of the essential criteria for approval of the Institute’s Limitation of Liability Scheme under Professional Standards Legislation. The scheme operates to cap liability of participating Institute members. This legislation, administered by the Professional Standards Council, requires participating occupational associations to implement strategies for monitoring and improving professional standards and protecting consumers.

This legislation ultimately protects the interests of consumers, enabling them to deal with professionals who have access to affordable professional indemnity insurance and who provide high quality services.
Measuring the effectiveness of the Program

We measure the effectiveness of the Program by closely monitoring the results of reviews, and assessing the reviews that fall into each result category and the number and significance of non-compliance issues. These results are included in this report. We also measure the effectiveness of the Program in terms of the remediation implemented by practices to address any non-compliance revealed during their review.

Cycle of continuous improvement

An effective Program contributes to continuously improving the quality of professional services being delivered by practices. This comes directly from the remediation actions taken by the practices in response to any issues identified as a result of their quality review. It also comes from the close collaboration between the Institute’s quality review team and other teams at the Institute.

Supporting practitioners

All our reviewers are experienced Chartered Accountants who work, or have worked in public practice. Quality reviewers have a unique relationship with practitioners, as peers who meet in practitioners’ own offices. This can add value to the process well above conducting quality reviews. Reviewers play a very important role in suggesting to practitioners how they can improve their practice, or sometimes simply by being a fellow practitioner they can talk to about professional and practice issues. Practitioners from small practices and/or regional areas often tell us how useful they find this face-to-face interaction. We facilitate this by providing samples of Institute tools and training materials to reviewers to demonstrate to practitioners how they can remediate or improve any issues that have come to light during reviews. Reviewers also play a vital role in communicating the views and challenges facing practitioners to Institute staff.

- We recently enhanced communication with and between reviewers by setting up a reviewer only portal on the Institute website. For the first time, reviewers can have conversations with the whole reviewer group, discussing review-related issues as they arise. This is also a useful way for reviewers to share tips and suggested documents they provide to assist practitioners.

‘We were very happy with our reviewer. He was punctual, professional, technically competent and friendly. The reviewer demonstrated a thorough knowledge of smaller accounting firms and their required control procedures. We appreciated his recommendations and believe they will enhance our practice and its operations.’

Anthony Carafa CA, Dobbyn & Carafa Pty Ltd

If reviewers identify non-compliance areas common to a number of practices, the Institute uses this intelligence to target these areas through training and development, publications and tools.

- During 2011–2012 we improved our response time to issues, increased our range of communications with members and developed specific training sessions highlighting ‘Top 10’ issues that need improvement.

Training and development based on quality review results

- Top 10 areas to improve your SMSF Audits (November 2011)
- Top 10 opportunities for strengthening audit independence – quality review results (February 2012)
- Quality review results: Top 10 opportunities for audit improvement (March and April 2012)
An initiative this year has been closer liaison between the Quality Review Committee and the Institute’s Public Practice Advisory Committee (PPAC). As well as ongoing alignment of the work of the two committees, members of PPAC have drawn on their practice experience to suggest ways we can enhance the effectiveness of the Program. Based on their suggestions, we have enhanced our communications with practitioners on quality-related issues including:

- A practical checklist based on the key results reported in the Quality Review 2011 Annual Report, including guidance on the issues and links to Institute tools to assist practitioners to monitor their own practices
- Additional guidance for practitioners on self-review/practice monitoring provided via a dedicated page on the Institute website
- More timely communications to alert members to issues as they arise during the year. For instance, initial reviews of audits conducted under the Clarity auditing standards revealed some practices were not issuing audit reports in accordance with the new standards. This was publicised to members immediately through the website and member newsletters.

We also continued our ongoing liaison with the Audit Advisory Committee (AAC). Of particular interest to AAC this year were insights provided by the review of the audit practices of major firms, and the preliminary results of reviews of audits conducted under Clarity standards.

During the year, the Institute significantly updated the Public Practice Program (PPP) to better cater for members from small and larger firms, providing greater flexibility with more tools and resources for partners in their practice. Members of the Institute’s quality review team have been involved in this update, providing input on the quality review process, and insights on key challenges facing practitioners.

Advocating improvements to regulation

The Institute represents the public interest and the interests of our members to government, regulators, standard-setters, industry, academia, and the general public by engaging our membership and local and international bodies on public policy, government legislation, and regulatory issues. In this way, we inform the public debate and are also able to update members on the latest developments.

The Program is integral to our advocacy, particularly on issues relating to public practice. Quality reviewers visit individual accounting practices, giving reviewers a unique insight into how regulations are applied in practice. The input of reviewers to the Institute’s advocacy is especially important in relation to issues for smaller practices, where the practitioners themselves rarely have time to be involved in advocacy activities.

Who is reviewed?

The Program is a risk-based cyclical model, both in the timing of reviews for practices and in the type of services reviewed within a practice. Practices are due for review three or five years after their last review. New practices are selected randomly for their first review.

Our Program aims to review practices at least once every five years. In most cases, this involves a reviewer visiting the practice and examining the practice’s manuals and workpapers. Under our existing model, a limited number of small practices are eligible for a self-assessment review rather than a reviewer visit.

We aim to review practices that sign-off on audits requiring a registered company auditor (RCA) registration at least once every three rather than five years. Monitoring RCAs every three years was introduced by the Institute in 2008 as the auditing standards became enforceable under the Corporations Act, reflecting the higher level of public accountability incumbent in these audits. In conducting reviews of RCAs, the Institute will consider ASIC’s inspection findings and modify the timing and scope of its reviews as a result.

1. Sole practitioners holding a full Certificate of Public Practice (CPP) are eligible to request a self-assessment review rather than be visited by a reviewer, if they are not RCAs and have gross fees under $50,000. This also applies to sole practitioners holding a concessional CPP at a one-third rate. This process will be reviewed in light of proposed amendments to SMO 1.
If significant non-compliance issues are revealed during a review of any type, the practice is reviewed within one year to ensure remedial action has been implemented by the practice.

**What happens in a quality review?**

We now apply a variety of review approaches, tailored to the differing sizes, structures and engagements of practices. This was foreshadowed by our 2010 thought leadership paper *Quality Review: past, present and future*, outlining the Program’s direction. Following on from this paper, we have now implemented an innovative review approach for the audit practices of major firms, and with the assistance of the Insolvency Practitioners Association (IPA) of Australia, enhanced the review of insolvency services. In the coming financial year we anticipate launching our tailored reviews for financial advisory services. In implementing these new approaches, we remain focussed on our fundamental objectives of adding value to reviews while minimising duplication.

All reviews have the same objective; to assess whether a practice has implemented an appropriate system of quality control, as set out in APES 320 and ASQC 1. These standards require practices to address the following elements of quality control:

- Leadership responsibilities for quality within the practice
- Ethical requirements, including compliance with the Code of Ethics (APES 110)
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance, including compliance with relevant standards and/or legislation
- Monitoring.

**Types of reviews**

Reviews of the major firms involved using an online quantitative audit quality survey to assess the perceptions of various respondent groups (partners, managers, qualified staff and graduates) on the firms’ commitment to the drivers of audit quality. For the compliance aspect of the reviews we relied on ASIC’s Audit Inspection Program and the firms’ national and international reviews, together with examining any remedial action taken by the firms. We will work with the firms to correlate findings from the survey with issues arising from their internal review program and ASIC inspection.

For reviews conducted by a reviewer visiting the firm, the reviewers base their reviews on questionnaires developed by the Institute. These review questionnaires are tailored to reflect the standards and regulatory requirements relevant to the specific engagements conducted by the practice and are freely available on the Institute website. This enhances the transparency of the Program, as well as providing a tool for practices to use for their own internal reviews between Institute visits.

Reviewers focus on assessing whether practitioners have applied policies and procedures that appropriately reflect standards and legislation in conducting engagements, rather than directly assessing the appropriateness of the opinions issued, or the advice provided, by members.

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**Types of reviews**

**Audit practice of major firms**

(with internal review processes and subject to ASIC inspection)

- Analysis of the drivers of audit quality in the firm
- Rely on ASIC reviews of audit engagement files

**Other practices**

- Reviewer:
  - Examines the practice’s manuals and working papers to evaluate the quality control system
  - Reviews a cross section of engagement files to assess whether quality control policies and procedures are being implemented

**Specialist practice**

Insolvency practice / Financial advisory practice

- Review conducted by a specialist reviewer; approach tailored to the speciality

**Sole practitioner**

conducting a micro practice

- Eligible for a self-assessment review
This assessment is based on the review questionnaires completed by the reviewer. After reviewing an engagement, reviewers come to an opinion as to whether there is any indication that:

- The engagement was not conducted in accordance with relevant professional standards
- The working papers are inadequate or insufficient.

For audit engagements the reviewer assesses whether there is any indication that:

- The audit was not conducted in accordance with Australian auditing standards
- The audit opinion was not based on sufficient documented and appropriate audit evidence.

Once the reviewer has completed their review, the outcome is presented to the practice in two ways. Firstly, the reviewer presents a report of their findings, and in many cases best-practice recommendations, to the practice. Practitioners are encouraged to comment on the report, which is then returned to the Institute together with the completed review questionnaires. Secondly, based on the reviewer’s report and practice comments, the Institute prepares and sends a review results letter.

Throughout a review, or at any other time, practitioners are welcome to contact the quality review team, managed by Assunta Corbo FCA, to discuss any queries or issues.

**What are the results of a review?**

After a review, the Institute issues the practice with one of the following four review results letters, explaining any departures from standards and/or regulatory requirements and remediation action required by the practice:

<table>
<thead>
<tr>
<th>Review results letter</th>
<th>Action required</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>No departures from professional standards</strong></td>
<td>Following the review, we would not take any further action as it appears there are adequate quality control procedures in place in the practice.</td>
</tr>
<tr>
<td>This applies to practices where the quality control policies and procedures appear adequate to comply with professional standards and regulatory requirements.</td>
<td></td>
</tr>
<tr>
<td><strong>Departure(s) from professional standards, not classified as serious</strong></td>
<td>We require the practice to confirm to us in writing that the issues identified in the review results letter have been addressed. Members are referred to guides/advice to help address the issues that were identified.</td>
</tr>
<tr>
<td>This applies to practices where quality control policies and procedures appear substantially adequate to comply with professional standards and regulatory requirements, and the policies and/or procedures appear to be generally adhered to. An example of a departure is where there is insufficient documented audit evidence in a particular area, although it is considered to be unlikely to affect the overall audit opinion.</td>
<td></td>
</tr>
<tr>
<td><strong>Follow-up review required</strong></td>
<td>The practice is required to develop an action plan within two months to outline how the issues identified are being addressed. A follow-up review is conducted within 12 months. If the action plan is not provided within the timeframe or it has not been adequately implemented at the time of the follow-up review, the practice will be referred for investigation.</td>
</tr>
<tr>
<td>This indicates the practice’s quality control policies and procedures may be insufficient to comply with professional standards and/or regulatory requirements, and/or existing policies and procedures have not been adhered to. An example of a departure is where there is insufficient documented audit evidence to support the overall audit opinion.</td>
<td></td>
</tr>
<tr>
<td><strong>Referral to the Institute’s disciplinary processes for investigation</strong></td>
<td>The practice is referred to the Institute’s disciplinary process for investigation.</td>
</tr>
<tr>
<td>This indicates a fundamental breach of standards and is referred to the Institute’s disciplinary processes for investigation. Our reviewer may also recommend referral for investigation where there appears to be a fundamental deficiency in the procedures or ethical behaviour of a practitioner or practice.</td>
<td></td>
</tr>
</tbody>
</table>
Remediation
A key objective of the Program is to maintain and support the high level of client service provided by our practitioner members. Where non-compliance with standards is identified during a review, we act to ensure the practice has addressed the non-compliance:

- The majority of reviews indicate that practices have appropriate quality control policies and procedures in place and any non-compliance with standards is not classified as serious. We require these practices to confirm they have addressed the issues identified within six months.
- Where more significant non-compliance issues have been identified, we work with the practice to address the issues. A practice is required within two months to develop and submit to the Institute a detailed action plan outlining the measures it is implementing to address each of the issues identified. We conduct a desk review to ensure the action plan is appropriate. Within one year a reviewer visits the practice to confirm measures outlined in the action plan have been implemented, and the areas of non-compliance have been effectively rectified. This approach is designed to ensure the practice remediates its policies and procedures within a reasonable timeframe and to check the revised policies and procedures are effectively implemented for the next round of annual client engagements.

In accordance with our Retention of, and Access to, Quality Review Documentation policy, issued in 2008, we also retain all quality review results letters, and any associated correspondence, on file. A copy of the review results letter and any associated correspondence will be provided to the practice at the time of their selection for their next review. These documents will also be provided to the reviewer for the next review to track progress at that review. The review results letter and any associated correspondence will be destroyed upon completion of the next review. This will allow quality reviewers to see how practices have progressed over time, by comparing the review result with the previous result.

Who are the quality reviewers?
All our reviewers are experienced practitioners who work, or have worked, in public practice, recruited because of their professional reputation and practice experience. Before they undertake any reviews they are required to complete a training day with the Institute and to sign strict terms and conditions. Reviewers who are in practice are also required to have recently satisfactorily undergone a review of their practice.

During 2011–2012 a number of new reviewers were trained and accredited as specialist audit or insolvency reviewers.

As Chartered Accountants, our reviewers are bound by the profession’s Code of Ethics (APES 110). They are also bound by strict agreements under the terms and conditions of their appointment with the Institute. These ensure a standard and professional approach to reviews and the confidentiality of all information encountered during a review. Reviewers are bound not to disclose any identifying information about the practice, its personnel or its clients other than to the Institute’s quality review staff, except:

- Where the review results in a referral to the Institute’s professional conduct division
- If compelled to by law.

The Program’s effectiveness is reliant on the independence and quality of the work of our reviewers. Their expertise and experience is matched as closely as possible to the types of engagements conducted by the practice under review to enhance the efficiency and effectiveness of reviews.

To monitor their work, and to promote consistency between reviewers, we have implemented a number of strategies:

- Reviewers for a practice are nominated by the Institute
- Reviewers and practitioners are required to declare any conflict of interest that would result in the reviewer not being independent of the practice. If there is a conflict of interest a different reviewer is nominated for the review
- Reviewers are evaluated by practitioners at the end of each review
- The reviewers’ workpapers are assessed by one of the Program’s technical consultants before the Institute sends the review results letter to the practice. All the technical consultants are experienced Chartered Accountants
- A different reviewer is appointed to a practice for each cyclical review.
Governance
The strategic direction and content of the Program is monitored by the Institute’s Quality Review Committee, comprising Chartered Accountants and non-members. The committee includes a quality reviewer and practitioner members from a cross-section of public practices, varying in size, specialisation and geographical location. The committee also includes an accounting academic and non-members, independent of the profession and the membership, to represent the public interest and to increase the transparency of the Program.

The committee monitors the Program’s efficiency and effectiveness, and keeps a close eye on regulatory changes and developments in other quality review programs in Australia and overseas to identify relevant issues and trends. Through this process the committee assists the Institute’s board and management to oversee and develop the Program, ensuring it continues to add value to practices and retains its world best-practice status.

More information on each member of the committee is included on page 28.

How does the Program maintain its integrity?
The Program is conducted in accordance with strict quality control procedures to ensure consistency and confidentiality of reviews, under the oversight of the Quality Review Committee.

We also benchmark our Program against programs conducted by regulators and other accounting bodies in Australia and overseas. In recent years we have made detailed comparisons with the programs of professional accounting associations in the US, the UK, New Zealand and Canada. We found that our program meets or exceeds international best practice in most respects, and where we find areas of improvement, we incorporate them into our Program. It is interesting to note that the non-compliance issues we identify most commonly are also identified in many other jurisdictions and by regulators.

Ensuring the integrity of the Institute’s membership categories is another important aspect of maintaining the integrity of the Program. Members holding an Institute Certificate of Public Practice (CPP) are subject to specific Institute requirements including an obligation to undergo a quality review as required. The Institute has a range of strategies in place to identify any members conducting a practice without holding a CPP or equivalent, or who hold a CPP unnecessarily.

During 2011 – 2012 we continued matching members of the Institute with ASIC’s register of RCAs. We know a number of members maintain their RCA status but are no longer conducting audits or any other client engagements, and we refer to these as ‘monitored members’. We have now written to all members who are RCAs and not monitored members or holding a CPP to clarify their status, and importantly to confirm they are not conducting audits or undertaking any other engagements that would require them to hold a CPP.

We are continuing this initiative with members holding other statutory registrations. Our next priority is registered company liquidators.

The federal government in June 2012 released details of the new registration process for SMSF auditors. From 1 July 2013, all SMSF auditors will be required to be registered with ASIC to conduct SMSF audits. This will enable us to match members with this register.

The review process assists in identifying members eligible to cancel their CPP, commonly because they are no longer in practice or no longer offering services requiring a CPP. In this case, these members cancel their CPP and their review does not proceed.

What are the limitations of the Program?

• For members in practice, a review is a mandatory part of Institute membership. It is conducted on a professional basis. It is not an investigation, as the Institute does not have legal power to seek information.

• Our members provide us with information as to who their clients are. We cross reference this information to publicly available information for auditors of public listed companies and to ASIC Annual Statements for Corporations Act audits, and for auditors of SMSFs once ASIC has established the SMSF auditor register. For non-audit clients we are reliant on information from the practice as this information is not publicly available.

• Prior to reviewing a client’s file, the practice is required to obtain written permission from the client. This is due to the duty of confidentiality owed by our members to their clients and we do not have the legal power to access information without the client’s written consent. Accordingly, the practice is aware of the files that the reviewer will review prior to client consent having been obtained and the files becoming available for review. We continue to encourage members to seek permission from their clients in the initial terms of engagement.
Enhancing audit quality

This section of the report highlights the Institute’s role in enhancing audit quality.

‘A strong audit profession is a key component in maintaining and promoting investor confidence and integrity in Australia’s capital markets. This is why the Institute promotes and supports audit quality at all levels.’

Lee White FCA, Institute CEO

Leadership

The Institute is increasingly viewed as a highly regarded commentator on current and emerging issues with particular expertise in the audit sphere.

The Institute has collaborated with a number of leading authorities to produce a series of leadership publications to guide audit committees.

In a unique collaboration with the UK regulator, the Institute developed the paper Walk the line: Discussions and insights with leading audit committee members, presenting an international view of the role, function and challenges facing audit committees. The function of the audit committee has come under the spotlight in recent times as a result of increased government intervention and the expectation for greater transparency and corporate accountability by the investor community. Produced in conjunction with the FRC in the United Kingdom and the Institute of Chartered Accountants of Scotland, the paper provides insights from a series of interviews with audit committee chairmen of publicly listed companies about the role and challenges facing audit committees. Institute CEO Lee White FCA says, ‘The audit committee essentially runs a balancing act between its oversight function and maintaining its relationships with colleagues. The paper finds there is great emphasis on audit committee chairmen forging relationships internally and externally to help inform them of the company’s activities.’

The paper examines the different relationships audit committees form with the board, management, external auditor and shareholders. It concludes with a series of questions for audit committee members to reflect on. The Institute hosted a high level forum with international guests to augment further discussion and debate on the role of the audit committee in helping the Board discharge corporate governance.

Another Institute publication, produced in conjunction with KPMG, is Governance, Risk and Compliance (GRC), which has been written to provide guidance to audit and risk committees in evaluating and improving their risk and compliance processes. The paper explores themes such as integrating GRC, implementing a strategic approach to GRC and why businesses are seeking a better approach to GRC activities.

Institute General Manager – Leadership and Quality Yasser El-Ansary CA says the publication highlights the need for organisations to align GRC activities with strategic direction, particularly amid a challenging economic environment. ‘A sound GRC framework results in company boards and senior management better identifying risks that could be detrimental to performance. It is critical that businesses adopt a strategic approach to GRC in making decisions that could impact their bottom line.’

The Institute developed a leadership publication in conjunction with PwC, Concise guide to managing business valuation risk, providing information for directors to assess their exposure to valuation risk, evaluate the board’s level of expertise to deal with valuation issues, and exercise appropriate due diligence when addressing questions around valuation risk. Mr White says it’s important that these questions around business value are asked. ‘It’s one step in the process of setting up dedicated controls to deal with this emerging category of risk.’

Advocacy

The Institute’s advocacy activities ensured the Australian Government’s reform of our audit system reflected the existing strong foundations of audit quality in Australia, resulting in minor enhancements only:

• Securing the extension of audit partner rotation from five to seven years, subject to audit committee approval. The then Head of Audit Andrew Stringer says, ‘This is a significant piece of reform; the first major reform for the audit profession since CLERP 9 in 2004. The Institute advocates developments to enhance audit quality and consulted with government throughout its review process’

• Negotiating an improved communication process, including an obligation that ASIC advise firms of direct communication with audit clients.
Participation by the Institute in the superannuation reform process secured federal government backing that the profession’s existing Code of Ethics (APES 110) remains the appropriate standard to govern auditor independence for all SMSF auditors.

Enhancing the co-regulatory regime

Monitoring auditor independence on behalf of the FRC

The FRC is a statutory body established under the ASIC Act. Among other activities it has responsibility for the effectiveness of the auditor independence regime in Australia. Rather than monitoring individual practices, the FRC relies on the reviews of the professional accounting bodies to fulfil this responsibility.

Under our memorandum of understanding with the FRC, the Institute monitors and reports on auditor independence as part of the review program. This includes reviewing each practice’s policies and procedures in relation to auditor independence, as well as considering whether these policies and procedures have been applied in individual audit engagements. If any issues related to independence are found, the Institute requires the practice to remediate the situation as soon as practicable. We are also proactive on independence issues. For example, we wrote to registered company auditors in 2009 (excluding Big 4 and mid-tier) as the auditor rotation requirements became fully operational, reminding them of their obligations and requiring confirmation they had appropriate rotation policies and procedures in place.

The FRC’s Annual Report for 2010 – 2011 states that the FRC was not aware of any deficiencies in either the systems or processes used by the professional accounting bodies for planning and performing quality reviews of audit work, or in the overall adequacy of the professional accounting bodies’ investigation and disciplinary activities.

Recent legislative changes remove duplication of ASIC and FRC monitoring of auditor independence so that ASIC continues its audit inspection program and the FRC focuses on providing strategic policy advice and reports on the quality of Australian audits. The Institute lodged a submission in October 2011 supporting this proposal.

Working with ASIC to enhance audit quality

We are committed to audit quality and support ASIC’s role in regulating auditors. During the past year we have been liaising closely with ASIC regarding our Program.

As mentioned previously in this report, an initiative of the Program has been to match members with ASIC’s register of RCAs. As such, we can ascertain whether our members who are RCAs are fulfilling their professional obligations, complementing ASIC’s regulatory activities.

Working with standard-setters to promote effective auditing standards

This financial year saw the first reviews of audit engagements applying the Auditing and Assurance Standards Board’s (AUASB) Clarity suite of auditing standards. We are monitoring the results of these reviews closely, to assist auditors to remediate their approach where necessary, and to inform the wider membership of any areas of concern arising from quality reviews. We do this so all auditors can benchmark their audit methodology against quality review results.
Ongoing, we are supporting the International Auditing and Assurance Standards Board’s (IAASB) Clarity monitoring project at the request of the AUASB. By working with a sample of small and medium practices we are assisting the IAASB to assess the effectiveness of the Clarity standards – both in terms of whether they result in improvements to audit practice and also to assess the effectiveness of their introduction. The AUASB and the Institute are keen to support this project, to provide feedback to the IAASB and thereby assist in the improvement of auditing standards internationally. This will also provide useful intelligence on how to improve implementation of future changes in Australia.

The Program is playing an important role in this project, obtaining members’ feedback on the Clarity standards as part of quality reviews. This will enable us to quantitatively measure the effectiveness of the Clarity standards, to add to the information gleaned from the detailed survey results from our sample of practices. Preliminary indicative results under Clarity standards are included in this report.

Enhancing governance over auditors of self-managed superannuation funds

Approved auditors of SMSFs are subject to an ‘approved auditor compliance program’ under the auspices of the ATO. The ATO has regard to the competency requirements and professional obligations imposed by the Institute on its members, including quality reviews and auditing and independence standards.

The federal government in June 2012 released details about the new registration process for SMSF auditors. Registration will be commencing from 31 January 2013 and as of 1 July 2013, all SMSF auditors will be required to be registered with ASIC to conduct SMSF audits.

Institute Head of Superannuation Liz Westover CA says the new registration process will raise the bar in SMSF audit quality in Australia. ‘One of the key drivers of audit quality is the ability to target communication and education to those operating in the area. With a succinct list of those conducting SMSF audits, the Institute will be able to deliver the right information directly to members offering SMSF audit services, to help ensure consistently high quality SMSF audits across the country.’

As part of the Stronger Super reforms the government also considered the issue of auditor independence for SMSF auditors, deciding to require all SMSF auditors to comply with the Code of Ethics (APES 110), as the Code provides the most appropriate independence framework. This is a position strongly supported by the Institute and we will continue on-going discussions with the Accounting Professional & Ethical Standards Board (APESB) on how the Code of Ethics (APES 110) applies in the SMSF context.

Supporting auditors

As auditing becomes an increasingly technical discipline, the Institute has correspondingly increased our investment in assisting members to achieve high quality audits. This has been of particular importance in the last year as auditors implemented revised audit methodologies, applying the Clarity auditing standards.

Member resources include an audit manual and toolkit, specifically designed with small audits in mind. During the year the Institute reissued an updated Australian Audit Guide for Self Managed Superannuation Funds. These are complemented by a range of training and development sessions and the Audit Conference presented around Australia, focusing on audit issues.

Professional scepticism is an essential attitude that enhances the auditor’s ability to identify and respond to conditions that may indicate possible misstatement. As highlighted in the IAASB staff paper (February 2012) it is in the public interest to re-emphasise to both auditors and others the important role that professional scepticism has to play in audits of financial statements. The Institute has done this by reminding auditors of the importance of scepticism in the Institute’s assurance and reporting newsletter, ANT, and through the reviewers’ website.

A full list of Institute guidance and tools available to assist members implement the Clarity standards is included in Appendix 3.
Quality Review Committee

Top left to bottom right: Lynn Ralph, Bill Hassell AM, Andrew Rigele CA (Chair), Denis Thorn CA, Nancy Milne, Rod Page FCA, Lucienne Layton. Not pictured: Dr Max Bessell FCA.
Andrew Rigele CA (Chair)
Andrew joined the committee in February 2009 and was appointed chair in December 2011. He is currently a partner in the Audit and Assurance team of Grant Thornton, responsible for coordinating the partner lead audit and other associated assurance services required to meet the requirements of a diverse portfolio of clients, including audits of privately owned businesses, not-for-profit organisations and listed public companies.

Dr Max Bessell FCA
Max is the Associate Head (International) at the Adelaide Business School, in the University of Adelaide. Apart from his international activities he also teaches and researches in accounting/auditing. His other experience in universities encompasses quality reviews and accreditations, degree developments and structures, strategic initiatives and academic management. Prior to joining the university sector Max spent over 18 years in legal and accounting firms. He joined the Quality Review Committee in 2003 and was Chair from June 2007 to December 2011.

Bill Hassell AM
Bill joined the committee in August 2008. Bill’s consultancy work over the past 20 years has involved him in activities for a wide range of major corporations, SMEs and industry bodies. Bill is also a former company director, and a former member of several Commonwealth Government Boards and Committees. Bill is a qualified lawyer with experience in company, commercial and property law, and a former Member of Parliament and Minister of the Crown in Western Australia. He was formerly Honorary Consul for Germany in Western Australia and is now working in a number of voluntary capacities.

Lucienne Layton
Lucienne joined the committee in August 2011. She operates in the risk, compliance and governance consulting space and also has extensive experience in transformational activities, such as mergers and restructures. She worked in this area for over 20 years as an in-house Risk and Compliance Manager, a senior regulator with ASIC and as a Partner with PwC in the Risk Advisory Practice. Most recently, she has worked with Westpac on the St George Merger and has been responsible for the restructure of the Group Risk and Compliance Team for BTFG.

Nancy Milne
Nancy joined the committee in June 2007. She is currently a consultant with Clayton Utz in Sydney, and prior to joining Clayton Utz was a partner at DLA Phillips Fox. Nancy is a non-executive director of a number of companies and serves on a number of audit and risk and compliance committees and was chair of Zurich Financial Services Australia until June 2008.

Rod Page FCA
Rod joined the committee in August 2008. He is a partner in a two-partner practice, which provides business advisory, taxation, and superannuation compliance services. Rod is also a reviewer for the Quality Review Program.

Lynn Ralph
Lynn joined the committee in November 2010. She was co-founder of corporate governance advisory firm, Cameron Ralph, and she has held the positions of Deputy Chairman of ASIC and CEO, Financial Services Council. Lynn is currently Commissioner, Private Health Insurance Administration Council; Chairman, BT Funds Management, and a non-executive director of a number of companies.

Denis Thorn CA
Denis joined the committee in December 2011. He is an audit partner in the Melbourne office of Ernst & Young and is also the Professional Practice Director for the Australian and New Zealand Assurance practice and the Financial Services Office. Denis worked in the Assurance practice of Arthur Andersen for over 20 years commencing in London then transferring to Sydney in 1983. He also manages the firm’s quality review program and regulatory inspections.
1. Co-regulatory environment
The following diagram illustrates the co-regulatory environment regulating the work of Chartered Accountants in Australia.

IFAC Obliges member bodies to conduct a mandatory Quality Review Program.

Institute of Chartered Accountants Australia Quality reviews consider the review work conducted by other bodies, provided there is sufficient documentation to rely on.

FRC Responsibility for monitoring the effectiveness of auditor independence requirements in Australia. The FRC has a memorandum of understanding with the Institute.

ATO Conducts compliance reviews of SMSF approved auditors as part of its compliance program in relation to Australia’s tax and superannuation laws.

Chartered Accountants in Practice Conducts quality reviews

Other regulatory bodies The activities of accounting practices are monitored by a range of regulatory and other bodies depending on the nature of the practice and type of engagement conducted. This includes the Tax Practitioners Board.

ASIC Has responsibility, under the Corporations Act, for the surveillance, investigation and enforcement of audit independence and audit standards. Its Audit Inspection Program is currently focused primarily on auditors of listed entities. From 2013 all SMSF auditors must be registered with ASIC.
## 2. Drivers of quality

The following table illustrates the five drivers of quality relevant to an accounting practice (including audit).

<table>
<thead>
<tr>
<th>The culture within the firm</th>
<th>The skills and personal qualities of partners and staff</th>
<th>The effectiveness of the firm’s process</th>
<th>Factors outside the control of the firm</th>
<th>The reliability and usefulness of reporting</th>
</tr>
</thead>
</table>
| 1. Governance and structure of firm, including the involvement of independent non-executives | 1. Recruitment  
- Technical skills and knowledge  
- Leadership skills  
- Personal skills and attributes  
- Communication skills  
- Team skills  
- Motivation | 1. Involvement of partners (including engagement quality control reviewer (EQCR)) and managers in planning process | 1. Quality of graduates to recruit | 1. Findings and results, systemic risks arising from internal review processes and external reviews |
| 2. Strategy | 2. Assignment of staff to engagement teams  
- Competence  
- Engagement size and complexity  
- Industry knowledge  
- On-the-job training  
- Need for specialists  
- Average experience level of staff on individual engagements  
- Average ratio of staff to partners on individual engagements | 2. Involvement of partners (including EQCR) and managers in review process | 2. Skills shortage | 2. PI claims/litigation costs |
| 3. Tone at the top | 3. Performance management  
- Technical excellence  
- Values  
- Knowledge of policies and procedures  
- Demonstrating compliance  
- Contribution within the firm  
- Reward and remuneration  
- Recognition of quality and risk indicators | 3. Consultation to reach appropriate conclusions | 3. Limitation of liability | 3. Communication with clients/stakeholders |
| 4. Risk management  
- Reputational risk  
- Behaviours which may result in a risk(s) which may impair or threaten to impair quality | 4. Career development/mentoring | 4. Resolution process (where a disagreement arises) | 4. Effective reporting framework | 4. Any restatements of financial statements? |
| - | 5. Training  
- Cost of training  
- Training costs per staff  
- Training hours per staff | 5. Identification of fraud  
- Policies and procedures to detect fraud  
- Number of frauds discovered? | 5. External factors which may impact on the ‘viability’ of the client (for example, global financial crisis) | 5. Payments of penalties on behalf of clients. |
| 5. Values | 6. Staff retention | 6. Internal review processes and external reviews  
- Findings and results, systemic risks  
- Remedial actions  
- Skills and knowledge of reviewers  
- Costs of internal review process | 6. Quality of audit committee or others charged with governance at clients. | |
3. Clarity suite of auditing standards: guidance and tools for members

**Guidance and tools**
(charteredaccountants.com.au/audit)

| **Australian Audit Manual and Toolkit** | Clarity version: an up-to-date guide to assist practitioners, incorporating the requirements of the ASAs in Clarity format |
| **Mandatory Requirements of Clarity Auditing Standards Checklist** | a tool to assist with compliance with Clarity auditing standards |
| **Clarity project website resources** | articles and a series of Q&As |
| **Audit and Assurance Training and Development** | a range of seminars, workshops and conferences including the **LiveOne** online series |
| **Institute’s Quality Control Guide** | guidance as well as sample policies, letters and workpapers, to help members meet the requirements of APES 320 and ASQC 1 |
| **Institute’s audit enquiry service** | free service discusses audit issues with members to help them access technical resources and guidance (02 9290 5702) |
| **Members’ Handbook** | containing regulations and standards that members must abide by in their work |
| **Framework for managing audit quality sustainability** | a concise guide to the components needed to manage a sustainable audit process |
| **Australian Audit Guide for Self Managed Superannuation Funds 2011** | designed with audit practitioners in mind, addressing the revised and redrafted ASAs in Clarity format |
| **Accounting & Assurance News Today** | weekly email newsletter prepared by the Institute’s reporting and assurance team including updates on Australian and internal auditing developments, and a Query of the Week on topical practical issues |
| **Review of Engagements Questionnaire** | prepared for use by Institute reviewers when reviewing engagements conducted under the Clarity standards, this is also useful for members when conducting a self-review of their audit practice |
| **Independence Guide** | The Institute, together with the two other professional accounting bodies is reviewing and updating the Independence Guide for auditors. In the meantime the current Independence Guide is available on our website |
### 4. Overview of standards

The table below provides further information around the key standards identified and referred to in the report.

#### Clarity auditing standards

(Applicable to audits of financial reporting periods beginning on or after 1 January 2010)

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASA 210: Agreeing the Terms of Audit Engagements</td>
<td>Requires the auditor to agree on the terms of engagement, document this agreement and forward it to the entity. It also requires the auditor to establish the preconditions for the audit.</td>
</tr>
</tbody>
</table>
| ASA 240: The Auditor’s Responsibilities Relating to Fraud in an Audit of a Financial Report | Requires the auditor to:  
- Identify and assess the risks of material misstatement due to fraud at the financial report level and the assertion level;  
- Evaluate the design of the entity’s related controls to determine whether they have been implemented;  
- Determine overall responses to address the risks of material misstatement due to fraud at the financial report level; and  
- Design and perform audit procedures to respond to the risk of management override of controls.  
The standard also requires written management representations relating to fraud, communication with management and those charged with governance; and establishes documentation requirements.  
A new requirement under the clarity standard is that the auditor is required to assess which types of revenue, revenue transactions or assertions give rise to such risks based on the presumption that there are risks of fraud in revenue recognition. |
| ASA 320: Materiality in Planning and Performing an Audit | Requires the auditor to determine materiality for the financial report as a whole when planning the audit, and if applicable, materiality for particular classes of transactions, account balances or disclosures; and performance materiality. |
| ASA 800: Special Considerations—Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks | The auditor’s report must include an ‘Emphasis of Matter’ paragraph that alerts the reader that the financial report is prepared in accordance with a ‘special purpose framework’ and consequently, may not be suitable for another purpose. |
| ASQC 1: Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements | Requires practices to establish a system of quality control to provide reasonable assurance that the practice and its staff comply with professional standards and regulatory and legal requirements and that reports issued by the practice are appropriate in the circumstances. ASQC 1 applies to all assurance practices regardless of size. |
Other auditing standards

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASA 230: Audit Documentation</td>
<td>Requires the auditor to prepare audit documentation that provides a sufficient and appropriate record of the basis for the auditor’s report.</td>
</tr>
<tr>
<td>ASA 500: Audit Evidence</td>
<td>Requires the auditor to obtain sufficient appropriate audit evidence on which to base the opinion.</td>
</tr>
<tr>
<td>ASA 210: Terms of Audit Engagements</td>
<td>Requires the auditor to agree on the terms of engagement, document this agreement and forward it to the entity.</td>
</tr>
<tr>
<td>ASA 220: Quality Control for Audits of Historical Financial Information</td>
<td>Requires the engagement partner to review the audit documentation to ensure sufficient appropriate evidence has been obtained before the auditor’s report is issued and that the engagement partner formed a conclusion on compliance with independence requirements that applied to the engagement.</td>
</tr>
</tbody>
</table>
| ASA 240: The Auditor’s Responsibility to Consider Fraud in an Audit of a Financial Report | Requires the auditor to:  
  - Identify and assess the risks of material misstatement due to fraud at the financial report level and the assertion level;  
  - Evaluate the design of the entity’s related controls to determine whether they have been implemented;  
  - Determine overall responses to address the risks of material misstatement due to fraud at the financial report level; and  
  - Design and perform audit procedures to respond to the risk of management override of controls.  
The standard also requires written management representations relating to fraud, communication with management and those charged with governance; and establishes documentation requirements. |
| ASA 300: Planning an Audit of a Financial Report                        | Requires the auditor to document the overall audit strategy, which considers the key decisions necessary to properly plan the audit. In addition, ASA 300 requires the auditor to prepare an audit plan setting out the nature, timing and extent of audit procedures at the assertion level. |
| ASA 315: Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement | Establishes mandatory requirements and provides explanatory guidance to the auditor on obtaining an understanding of the entity and its environment and assessing the risks of material misstatement in a financial report audit. This auditing standard:  
  - Requires the auditor to perform risk assessment procedures to obtain an understanding of the entity and its environment, including its internal control;  
  - Requires the engagement team to discuss the susceptibility of the entity’s financial report to material misstatements, including those due to fraud;  
  - Requires the auditor to understand specified aspects of the entity and its environment, including its internal control components;  
  - Requires the auditor to assess the risks of material misstatements both at the financial report and assertion level;  
  - Requires the auditor to identify significant risks and assertions where substantive procedures alone will not be sufficient;  
  - Requires the auditor to communicate with those charged with governance or management material weaknesses in the design and implementation of internal control that have come to the auditor’s attention; and  
  - Outlines the documentation requirements of the auditor. |
| ASA 520: Analytical Procedures                                           | Requires analytical procedures to be applied to obtain an understanding of the entity and its environment: at the planning stage of the audit and prior to forming an opinion on the financial report. |
Other auditing standards (continued)

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASA 560: <em>Subsequent Events</em></td>
<td>Requires the auditor to perform procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the auditor’s report that may require adjustment of, or disclosure in, the financial report were identified.</td>
</tr>
<tr>
<td>ASA 570: <em>Going Concern</em></td>
<td>Requires the auditor to evaluate management’s assessment of the entity’s ability to continue as a going concern.</td>
</tr>
<tr>
<td>ASA 580: <em>Management Representations</em></td>
<td>Requires the auditor to endeavour to obtain written representations from management on matters material to the financial report, when other sufficient appropriate audit evidence does not exist.</td>
</tr>
</tbody>
</table>

Professional and ethical standards and regulation

<table>
<thead>
<tr>
<th>Standard</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>APES 110: <em>Code of Ethics for Professional Accountants</em></td>
<td>Requires the practice to implement and document appropriate safeguards to reduce the threat to independence to an acceptable level.</td>
</tr>
<tr>
<td>APES 205: <em>Conformity with Accounting Standards</em></td>
<td>Requires members involved with the preparation, presentation, audit, review or compilation of financial statements, which are either General Purpose Financial Statements or Special Purpose Financial Statements, to apply Australian Accounting Standards Board (AASB) accounting standards as appropriate.</td>
</tr>
<tr>
<td>APES 220: <em>Taxation Services</em></td>
<td>Requires members to provide clients with a statement in writing that the client is responsible for the accuracy and completeness of the information they provide. This statement can be provided in a number of ways such as a letter, standard handout, brochure or electronic communication.</td>
</tr>
<tr>
<td>APES 305: <em>Terms of Engagement</em></td>
<td>Requires members to document and communicate the terms of engagement when providing professional services. This can be done in a variety of ways, such as a letter, agreement, standard handout, brochure or electronic communication. APES 305 also requires a member who is a participant in a scheme to advise their clients that the member’s liability may be limited.</td>
</tr>
<tr>
<td>APES 315: <em>Compilation of Financial Information</em></td>
<td>Requires a statement to be made, where relevant, that the member is not independent of the client and/or identify the financial information to which it related. APES 315 also requires members to obtain an acknowledgement from the client of their responsibility for the reliability, accuracy and completeness of the accounting records and disclosure of all material and relevant information.</td>
</tr>
<tr>
<td>APES 320: <em>Quality Control for Firms</em></td>
<td>Requires practices to establish a system of quality control to provide reasonable assurance that the practice and its staff comply with professional standards and regulatory and legal requirements and that reports issued by the practice are appropriate in the circumstances. APES 320 applies to all practices regardless of size.</td>
</tr>
<tr>
<td>R7: <em>Regulations Relating to Training and Development</em></td>
<td>Requires all members to undertake a minimum level of training and development, to undertake at least 40% of the minimum training and development requirement in each speciality area, and to keep a personal record of the time spent on training and development activities. Members who audit SMSFs are required to dedicate 30 hours of their training and development activity over each three-year period to relevant activities in addition to the requirements above.</td>
</tr>
</tbody>
</table>
5. Glossary of terms

<table>
<thead>
<tr>
<th>Abbreviation/acronym</th>
<th>Name</th>
<th>Website (where applicable)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AASB</td>
<td>Australian Accounting Standards Board</td>
<td>aasb.gov.au</td>
</tr>
<tr>
<td>APESB</td>
<td>Accounting Professional &amp; Ethical Standards Board</td>
<td>apesb.org.au</td>
</tr>
<tr>
<td>AQRB</td>
<td>Audit Quality Review Board (which completed its three year charter in February 2009)</td>
<td></td>
</tr>
<tr>
<td>ASAs</td>
<td>Australian Auditing Standards</td>
<td></td>
</tr>
<tr>
<td>ASIC</td>
<td>Australian Securities and Investments Commission</td>
<td>asic.gov.au</td>
</tr>
<tr>
<td>ATO</td>
<td>Australian Taxation Office</td>
<td>ato.gov.au</td>
</tr>
<tr>
<td>AUASB</td>
<td>Auditing and Assurance Standards Board</td>
<td>auasb.gov.au</td>
</tr>
<tr>
<td>CPP</td>
<td>Certificate of Public Practice</td>
<td></td>
</tr>
<tr>
<td>FRC</td>
<td>Financial Reporting Council</td>
<td>frc.gov.au</td>
</tr>
<tr>
<td>GAA</td>
<td>Global Accounting Alliance</td>
<td>globalaccountingalliance.com</td>
</tr>
<tr>
<td>IAASB</td>
<td>International Auditing and Assurance Standards Board</td>
<td>ifac.org/iaasb</td>
</tr>
<tr>
<td>IFAC</td>
<td>International Federation of Accountants</td>
<td>ifac.org</td>
</tr>
<tr>
<td>IPA</td>
<td>Insolvency Practitioners Association of Australia</td>
<td>ipaa.com.au</td>
</tr>
<tr>
<td>RCA</td>
<td>Registered company auditor</td>
<td></td>
</tr>
<tr>
<td>SMSFs</td>
<td>Self-managed superannuation funds</td>
<td></td>
</tr>
<tr>
<td>The Committee</td>
<td>Quality Review Committee</td>
<td></td>
</tr>
<tr>
<td>The Institute</td>
<td>Institute of Chartered Accountants Australia</td>
<td>charteredaccountants.com.au</td>
</tr>
<tr>
<td>The Program</td>
<td>Quality Review Program</td>
<td>charteredaccountants.com.au/qualityreview</td>
</tr>
<tr>
<td>TPB</td>
<td>Tax Practitioners Board</td>
<td>tpb.gov.au</td>
</tr>
</tbody>
</table>
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