



20 December 2017

██████████
Chair
Financial Reporting Council
c/- The Treasury
Langton Crescent
Canberra ACT 2600

Dear ██████████

AUDIT QUALITY

Thank you for your letter of 24 November 2017 seeking APRA's engagement on audit quality and maintaining investor confidence in the information presented in financial reports.

APRA welcomes the opportunity to engage with the Financial Reporting Council (FRC) on audit quality. This is a topic that has received attention in regulatory fora around the globe.

Improving audit quality enhances the integrity of information produced under the accounting framework, and is beneficial to a number of stakeholders, including prudential supervisors. Prudential supervisors rely on high quality audited accounting information to understand key risks and determine a regulated entity's capital position. APRA is supportive of lifting the quality of the audit profession's framework and to identify the risks and weaknesses with existing audit practices and auditor's reports.

The Australian Securities and Investments Commission (ASIC) conducts its audit inspection program in accordance with its mandate. APRA and ASIC engage on the findings of this work where it relates to APRA regulated institutions. The engagement with ASIC on auditing and accounting matters is ongoing and collaborative. In terms of ASIC's recently released results of its audit firm inspections for the 18 months to 31 December 2016 (ASIC REPORT 534: Audit inspection program report for 2015–16), APRA notes:

- The inspections covered a small number of APRA banking and insurance entities (4 out of 93 or 4.5 per cent of the sample). Any extrapolation made to a broader sample of APRA regulated entities should be undertaken with caution.
- Certain issues such as the use of fair values for prudential capital purposes have been reviewed as part of APRA's ongoing prudential supervision. The prudential framework requires fair values to be reliable for prudential capital purposes. ASIC's findings on fair value internal controls and processes is complementary to our work and supports fair value reliability.

APRA liaises with appointed auditors under tripartite arrangements which involves APRA, the regulated entity and the auditor. Under these arrangements, APRA requests auditors prepare routine and special purpose reports in accordance with its prudential standard requirements. The special purpose reports usually focus on specific risk topics or themes (e.g. serviceability in the banking sector).

In the context of APRA's regular supervisory activities, APRA will engage directly with the auditor to clarify expectations whenever specific audit quality issues are detected. This ensures corrective action is taken on a timely basis. APRA's prudential standard requirements on audit and related matters are supported by AUASB Guidance Statements.

APRA is engaged in global initiatives on audit quality through the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB). For the past two years, APRA has been involved in meetings organised by the FSB with the International Forum of Independent Audit Regulators (IFIAR) and the Global Public Policy Committee (GPPC) on audit quality. These meetings indicate that the topic of audit quality is being taken seriously by IFIAR and the GPPC.

We also note that enhancements are being made to certain auditing standards (e.g. Proposed *ISA 540 Auditing Accounting Estimates and Related Disclosures*) and expect that these changes will have benefits from an audit quality perspective.

Finally, APRA observes there are several new accounting standards (e.g. Financial Instruments, Leases, Revenue and Insurance Contracts) that will progressively apply from 1 January 2018 onwards. These standards place a greater emphasis on the relationship between an entity's business model and risk management practices, and require a number of subjective judgements that might impact on audit quality. APRA stands ready to engage with the FRC and the accounting and auditing standard setting bodies as these pronouncements come into force.

Please feel free to contact [REDACTED] or [REDACTED] should you wish to discuss this letter further.

Yours sincerely,
[REDACTED]