ROCpod episode 23 – Is it time to change your registered auditor?

Speaker Key

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DC Hello, and welcome to ROCpod: Talking with the Registered Organisations Commission. Thanks for tuning in to our episode about the rotation of auditors. My name is Declan Clifford and I am the Executive Officer to the Registered Organisations Commissioner.

We're talking about the rotation of auditors because it is a hot topic right now. We know some reporting units are already reaching the point where they need to change their auditor.

So to explain what this requirement means for registered organisations and auditors, and to answer some of the common questions we're being asked, I have with me Joanne Fenwick. Joanne is the ROC's Financial Reporting Specialist.

Thanks for your time.

JF You're welcome, Declan.

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DC So let's start with the basics. When was the requirement introduced?

JF The auditor rotation requirement was introduced into our legislation in May 2017, and as you've said, some reporting units are now reaching the point where they need to act. This is a continuing requirement, so it's something that all reporting units and registered auditors must be aware of, not just now, but also into the future. We welcome all opportunities to help organisations and auditors understand what the requirements means for them so they can achieve compliance.

I also encourage people to download our factsheet about the rotation of auditors, which explains the requirement and answers some frequently asked questions.

DC Now you mentioned our legislation. That's the Fair Work (Registered Organisations) Act (or we call it the RO Act). Can you give a brief explanation of the auditor requirements under the RO Act?

JF Sure. The RO Act requires a reporting unit to appoint an auditor to audit their financial report. Essentially, the auditor conducting the audit must be registered by the Registered Organisations Commissioner, and is what we will refer to as a registered auditor. The RO Act also describes the powers and duties of auditors.

You can also access our register of auditors on the ROC website to check before any appointments are made that a person has been properly registered as an auditor. The registration requirement is important. Registration confirms the auditor is qualified with the necessary practical experience.

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DC If you want to become a registered auditor under the RO Act, there's an application form on the ROC website. This is a separate process to registering with ASIC.

So a reporting unit must ensure that the registered auditor audit's its financial report. It also needs to keep track of how long they engage a registered auditor, doesn't it?

JF That's right Declan. The RO Act limits the amount of time that auditors can *'play a significant role'* in the audit of a reporting unit's financial report.

Under section 256A of the RO Act, an individual cannot *'play a significant role'* in the audit of a reporting unit for more than 5 consecutive financial years, or 5 out of 7 consecutive financial years. There are good reasons for this. It helps to promote auditor independence and avoids bias in the assessment.

Registered company auditors will be familiar with a similar rotation requirement under the Corporations Act, which is regulated by ASIC.

DC Now you said an auditor cannot *'play a significant role'* for 5 consecutive financial years, or 5 out of 7 consecutive financial years. What exactly does it mean to *'play a significant role'*?

JF The RO Act explains what this means. The meaning is however different for when the position of auditor is held by an individual, or when it's held by a company or firm.

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DC Okay let's start with an individual auditor. What does *'play a significant role'* mean for an individual?

JF So an individual auditor will *'play a significant role'* if they are the registered auditor for the reporting unit for the financial year.

DC Okay and what does it mean when the auditor is a firm or company?

JF So if the auditor is a firm or a company, a person acting on behalf of that company and is a registered auditor will *'play a significant role'* if they participate in the preparation of an audit report or if they conduct an audit for the reporting unit in the financial year or any part of the financial year.

DC Okay, so if a reporting unit has been using the same person from a firm for 5 consecutive financial years, they can use a different registered auditor from the same firm as their auditor for the following year?

JF Yes that's right, they can use a different auditor from the firm, but the second auditor must also be a registered auditor. I'll give you an example because it's one of the common questions that has been asked.

Let's say a reporting unit engages an auditing firm called ABC auditing as their auditor. Sally from ABC auditing has audited the financial reports of the reporting unit for five consecutive financial years. This would mean that next year, the reporting unit can't use Sally again because of the rotation requirements. But Sally has a colleague in the firm, Joseph, who is also a registered auditor. Joseph can then audit the reporting unit instead of Sally for the next financial year.

If a registered organisation has a contract with an auditing firms, by using a different registered auditor from the firm they can fulfil their contract and remain compliant with the RO Act.

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DC You explained earlier that the limits are counted by consecutive 'financial years'. That's usually a 12 month period, isn't it?

JF So a financial year is usually a 12 month period, but it's not always the case. It's important to accurately calculate the financial years to avoid falling into non-compliance with the rotation requirement.

DC Okay so when could a period less than 12 months be counted as a 'financial year' for the rotation requirement?

JF So an example is where a registered organisation amends its rules to change its financial year. The rules of a registered organisation can specify the financial year of the organisation and if applicable, each of its branches. If the rules do not specify a financial year, the default financial year under the RO Act commences on 1 July in any year. You might be surprised to know there are 7 different financial years among our federally registered organisations. We've seen some organisations change their financial year from one 12 month period to a different one.

So for example, a reporting unit might have changed its financial year from a 30 September financial year end to a 30 June financial year end. In changing the financial year, the reporting unit will shorten the period of actual time that a person can act as its auditor. This is because a smaller transitional financial year is created and is deemed a 'financial year', it is included in the number of consecutive financial years.

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DC So counting the period of time won't actually always be as straightforward as multiplying a 12 month period by 5 years. It's important to be aware that you might need to rotate your auditor within a shorter period.

Now Joanne you stated earlier that this required commenced in May 2017. Was there any transitional arrangements with the introduction of this new requirement?

JF Yes there was a transitional period of 3 months after 1 May 2017, which allowed what the RO Act previously referred to as an 'approved auditor' to be transitionally recognised as a 'registered auditor'.

DC So what if the auditor was transitionally recognised as a registered auditor when they conducted and completed an audit for a financial year during this 3 month timeframe? Does that count as a financial year too?

JF Yes, so under the RO Act this will count as one consecutive financial year, even though the auditor was 'transitionally recognised' during this period of time.

DC You've also spoken about the limit of 5 consecutive financial years or 5 out of 7. In 2021 some reporting units may have to rotate their auditor for the first time. When does the ROC start this count? Does it start from 1 May 2017?

JF So the ROC counts every audit that the auditor has completed since 1 May 2017. And we also count audits of financial years that began before 1 May 2017 where the audit was signed after 1 May 2017.

With the help of the ROC's case management system, we can keep track of how long an auditor has consecutively audited the financial reports of a reporting unit. We can then identify when organisations fall into non-compliance.

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DC To assist registered organisations and auditors to comply, the ROC will notify auditors and organisations by letter, when our system triggers that a rotation may need to occur.

JF Yes that's correct. Look we know our courtesy letters assist with compliance, but it's also important that organisations and auditors don't rely on them to achieve voluntary compliance. It is ultimately the responsibility of the registered auditor and each reporting unit to ensure compliance.

We recommend that registered auditors and registered organisations also track how many consecutive financial years the auditor has audited the financial reports for the reporting unit.

If you're not sure about who has audited your financial reports in previous years, you can find out this information by downloading your financial reports on the ROC website. The auditor's report relevant to each financial report will tell you the name of the registered auditor who has signed off on the audit for that particular financial year.

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DC So let's say an organisation has received a ROC courtesy letter and its own calculations confirm it needs to rotate their auditor for the next financial year. If the reporting unit wanted to use its original auditor again in future, how soon can they do this?

JF This is actually a common enquiry we've had from organisations. If the auditor has completed an audit for five consecutive financial years, the reporting unit must wait until after two audits by a different registered auditor before the earlier registered auditor can again audit the reporting unit's financial report.

DC What happens if a reporting unit has appointed an auditor, and then discovers the auditor would be breaching the RO Act if they audited the reporting unit? I understand the RO Act controls how to remove an auditor during their appointment, is that correct?

JF That's a good question, and it highlights the importance of keeping track of how long you've engaged the same auditor so you can avoid this issue.

It's easier to be proactive before you appoint an auditor, than to follow the process to seek to remove an auditor. Section 263 outlines the process for removing an auditor, and there are steps that will need to be followed. What those steps are for a reporting unit will actually depend how they have appointed their auditor. For example, if the auditor was appointed at a general meeting of members, the reporting unit would need to pass a resolution at a general meeting of members to remove the auditor, you'd need the majority of members to support it. This kind of process exists for a good reason. It helps to ensure that members have access to a transparent financial report, that is free from coercion.

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DC What else can a reporting unit do in this situation?

JF We'll always advise you try to prevent non-compliance but if you need to rectify non-compliance, you need to do it at the earliest possible stage.

If you've already appointed an auditor and you think the auditor would be breaching the RO Act if they do the audit, you should raise this with the auditor immediately. The auditor will be risking a financial penalty, so they may voluntarily resign the appointment to avoid breaching the Act. You could then appoint a different registered auditor to do your audit.

Now there might be other options available – all circumstances are different – and organisations can always give the ROC a call so we can explore all the options.

DC So when a reporting unit needs to rotate their auditor, would you say there are any practical measures they can put in place to help with the transition to a different registered auditor? Some reporting units have used the same auditor for years, and they might want to plan for the change.

JF So a starting point would be to provide the auditor with information on the structure of the reporting unit, an overview of its systems and procedures and even a copy of the organisations rules. An organisations rulebook does contain requirements relating to its financial management, governance, and operational obligations. You should always confirm that the auditor has a copy of the RO Act and the most recent reporting guidelines…remember this is what they are auditing you against and how the ROC measures compliance.

An auditor is entitled to full and free access to all records and documents relating to the financial affairs of a reporting unit and can also seek information and explanations for the purpose of the audit from designated officers and employees. You should make sure that the records and information they require are available and accessible including the relevant personnel.

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DC If you're looking for more information about the role of auditors, you can also go back and listen to our first episode of ROCpod – What to expect from your auditor. In this first episode, we spoke to a Policy Adviser at CPA Australia about how organisations can prepare for an audit and how to manage the professional relationship.

Now Joanne, you mentioned earlier the potential penalties that a Court can impose for a breach of the rotation of auditor's requirement. Could you finish off today's episode by explaining the civil penalties?

JF Yes sure. Under the RO Act, a Court can impose a penalty of up to 200 penalty units on a registered auditor if they are found to have breached the requirement. So to put that into context, 1 penalty unit is currently worth $222, so 200 penalty units is equivalent to $44,400. And if the registered auditor is part of a firm that is a corporation, the firm could potentially be exposed to a civil penalty that is five times greater; of up to $222,000. So we're talking what could potentially be quite a large penalty, and of course it's something auditors would want to avoid if they can.

DC Absolutely, look thank you, Joanne. To summarise today's episode:

The RO Act limits the time that auditors can play a significant role in the auditing of a reporting unit's financial reports. It is fundamental to auditor independence that reporting units rotate their auditor. We recommend that registered auditors and registered organisations put systems in place to ensure compliance, and one way to do this is to track how long you have engaged your auditor. Breaches of the rotation requirement may result in a financial penalty imposed by a Court.

Thank you so much for your time today, Joanne. You've given us lots of practical information for organisations and auditors to think about.

JF You're welcome, Declan. Now look I encourage registered auditors and organisations to download our rotation of auditors fact sheet, and if you have further questions get in touch with us. We've also released our national Education Strategy for the new financial year, which includes a schedule of our education resources and events over the next 12 months. For example, a new resource we'll be releasing in July 2021 is a compliance update about the use of credit cards. The compliance update will reveal some of the issues we've uncovered in inquiries and investigations relating to credit cards, and it will suggest practical strategies for organisations to prevent misuse.

DC Thank you for joining us on another episode of ROCpod. Next month we'll be talking governance with the Registered Organisations Commissioner Mark Bielecki.

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