Submission to ASIC: Cost Recovery Implementation Statement: ASIC industry funding model (2019-20)

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Dear Sir/Madam

ASIC Cost Recovery Implementation Statement: ASIC industry funding model (2019-20) – consultation

The Institute of Public Accountants (IPA) welcomes the opportunity to provide our comments on the Cost Recovery Implementation Statement (CRIS) 2019-20.

The IPA is one of the three professional accounting bodies in Australia, with approximately three-quarters of our 38,000 members working in, or advising, the small business and small-to-medium enterprise (SME) sectors. Our members include Registered Company Auditors (RCAs), SMSF auditors, registered liquidators, financial services licensees, credit providers and advisers across the superannuation sector.

Summary

Overall, we believe that the CRIS does not make the case for the indicative amounts that have been costed, which in some cases are excessive, disproportionate, reduce competition, lack transparency and have not taken the economic and financial impact of the COVID-19 pandemic into account. We note that the CRIS, even though it was released on 12 June 2020, states that it does not reflect ASIC's adjusted work program to respond to the pandemic (page 4). We believe this is unrealistic given that all regulated entities have had to adjust in dealing with the impacts. Responding to an event of this significance cannot be delayed and should have been reflected in the CRIS and subject to stakeholder consultation.

Revenue raising in the age of COVID-19

The ASIC Annual Report 2018-19 states that in 2018-19, ASIC raised $1,273 million for the Commonwealth in fees, charges and supervisory cost recovery levies, an increase of 5% from the 2017-18 year, which was a 32% increase from the previous year (pages 35-6). Total income was $1,343,493,000 (page 168).

'Fees and charges collected for the Commonwealth' have increased from $824 million in 2014-15 to $1,273 million in 2018-19 (page 265), being an increase of 54% over four years.

In 2018-19, ASIC's total revenue was $385.8 million ($374 million in appropriation revenue from the Government and the rest being own-source revenue). This was a $26 million or 8% increase compared with 2017-18, mostly due to new budget measures. There is also an additional $474 million over four years to address misconduct following the Hayne Royal Commission.

Total (operating) expenses in the same period were $431.1 million, being a deficit of $45.4 million (page 36). This would indicate that the principle of cost recovery may not provide ASIC with an incentive to operate on a least cost basis. Moreover, the fact that annual expenditure repeatedly exceeds annual appropriations indicates that ASIC is not operating as efficiently as it could be.

The CRIS states that ASIC's regulatory costs will continue to be funded through appropriation from the Commonwealth budget. In 2019-20, $324.5 million of ASIC's total budgeted resources of $429.6 million, that is, 75.5%, are expected to be recovered via ASIC's cost recovery levies and statutory levies (page 9).

Cost recovery and fees-for-service are different concepts with the latter having the capacity to lead to significant revenue raising. We are of the view that the Financial System Inquiry did not intend this outcome and that its focus was on cost recovery rather than revenue raising.

Key point: we appreciate that ASIC's revenue goes to the Commonwealth as part of consolidated revenue, however, the 'surplus' of $914 million plus additional appropriations, provides significant capacity for ASIC to reduce fees and levies, especially in the current environment. ASIC's overall revenue is still increasing despite the pandemic, whilst that of many of the regulated entities is decreasing.

Fees-for-service methodology

The CRIS states that the methodology for calculating the costs for fees-for-service activities is based on the Cost Recovery Guidelines. Each of the regulatory activities are broken down into distinct outputs and the key business processes that are used to produce those outputs. The relevant costs are then identified and attributed to the outputs and processes. Costs are attributed using a weighted average hourly rate, which is based on each team involved in the business process and includes indirect costs (made up of property, IT and corporate services costs), apportioned according to average FTE staff.

Based on the worked examples on pages 150-1 of the CRIS, we note that whilst some of the work undertaken by ASIC may involve high levels of expertise, the majority seems to be either administrative, repetitive or does not require a high level of expertise given that small practices do not inherently involve high levels of sophistication. According to the annual data IPA collects for the Professional Standards Councils, including insurance claims data, most of our practitioner members have a low level of risk given the type of work and clients they have. This is the case whether they are auditors, liquidators or financial advisers.

A risk rating system is a beneficial overlay when deciding on the level of supervision and surveillance and this should be reflected in the fees and charges. It is not evident whether this is part of the ASIC CRIS methodology. If not, this would make the outcomes more equitable, even if the methodology becomes marginally more complex.

Many professional advisers have moved away from charging on the basis of hourly rates and charge according to the value and/or outcomes created for clients. ASIC could consider a similar approach for its less complex activities.

Key point: the CRIS methodology should be refined to reflect standard market and industry practices and a risk profile of regulated entities – this would result in more equitable outcomes.

Indirect costs

We were unable to find a reasonable explanation in the CRIS or in other ASIC documents for 'indirect costs'. We note comments about leases, staffing and 'supplier' costs. However, given that these indirect costs are relatively high, more transparency would be welcome. Most businesses are under pressure to reduce costs, from having to move to less expensive office locations, to driving efficiencies at all levels, and there is a community expectation that government will do likewise. Whilst we appreciate that ASIC has more functions and responsibilities and that more funding has been provided, we expect cost savings will be made where appropriate.

We also question why industry is being charged for 'policy advice' or 'central strategy' and we are unsure of what these are. Even being charged for 'education' or 'stakeholder engagement' seems excessive. Many regulated entities go to education institutions or their professional association for accredited/recognized education, training and information. We appreciate that some entities may benefit from education or information from ASIC, however, for many, education is costly enough without having an additional charge for something they may not be accessing. Why is industry being charged for engagement with themselves. We would expect this to be a standard regulator activity that is part of the cost of 'doing (government) business' and accordingly should be met by government.

Key point: unless there are compelling reasons to include indirect costs in the CRIS, then we believe that all indirect costs should be removed from the funding model.

Transparency and accountability

The Cost Recovery Guidelines note under the heading of 'accountability' that meeting the principle of transparency and accountability involves reporting on performance for the activity on an ongoing basis. The Guidelines add that access to information about ASIC's fees-for-service activities can help stakeholders determine whether cost-recovered activities are being implemented efficiently and effectively.

IPA agrees that transparency and accountability are critical for the successful implementation of the funding model. For this reason, more information is needed on the actual break down of the activities, the indirect costs and the linkages between the costs and performance metrics.

In addition, it would be useful to have more information in one place rather than scattered across numerous documents. We note that the CRIS contains a long list of related information (pages 205ff). Many of these are relevant to understanding the CRIS including the annual report (which includes the annual performance statement), annual corporate plan, Australian Government Charging Framework and its Resource Management Guide 302, Cost Recovery Guidelines, Regulator Performance Framework (RPF) and ASIC's self-assessment against the RPF.

However, there are many other related documents such as numerous industry levy instruments, related legislation, ASIC Service Charter, ASIC (Fees—Complexity Criteria) Instrument 2018/578, numerous reports (eg Report 650 licensing and professional registration, Report 659 compliance review of documents, Report 654 assessing applications for relief), numerous regulatory guides, market integrity report, enforcement update report and so on.

A simplified document for users/stakeholders, perhaps on an industry/sector basis, with relevant information only, would be useful.

Key point: transparency and accountability would be enhanced by more clearly demonstrating linkages between costs, performance and outcomes. This should be done in one streamlined document rather than scattered among a plethora of documents.

Performance

In addition to the Charging Framework, ASIC must also have regard to meeting its KPIs and working within the RPF. All of the KPIs listed below are relevant to the CRIS and the methodology that has been developed. The RPF consists of the following six KPIs:

KPI 1: Regulators do not unnecessarily impede the efficient operation of regulated entities
KPI 2: Communication with regulated entities is clear, targeted and effective
KPI 3: Actions undertaken by regulators are proportionate to the regulatory risk being managed
KPI 4: Compliance and monitoring approaches are streamlined and coordinated
KPI 5: Regulators are open and transparent in their dealings with regulated entities
KPI 6: Regulators actively contribute to continuous improvement of regulatory frameworks.

The latest self-assessment under the RPF for 2017–18 was published in April 2019. Given that the CRIS takes into account ASIC's self-assessment against the RPF, it would be beneficial to align the two periods and documents.

Key point: many of our comments in this submission are relevant to ASIC's KPIs, that is, not impeding efficient operations, clear and effective communication, proportionality to risk, streamlined compliance, transparency and continuous improvement.

Risk assessment – timing and certainty

We note that the risk assessment for the fee for service model is assessed in the CRIS as medium risk. The CRIS acknowledges the potential risks of the fees-for-service model include:
• the perception that the model lacks transparency about the basis of the fees;
• the fees for service may not match our actual regulatory costs;
• uncertainty about the classification of tiered fees; and
• the tiered fees could result in some entities being subject to a large increase in fees if they fall within the complex category.

It goes on to state that risks can be appropriately mitigated and managed by increasing the level of consultation and communication with stakeholders to ensure maximum transparency and understanding.

It is unreasonable for ASIC to apply estimates and expect that regulated entities can absorb huge (or any) fluctuations when they are operating in the same uncertain environment as ASIC, have their own costs to meet and cannot always pass these on to clients and customers. Many of our members charge monthly or fixed fees based on a contractual arrangement, as clients have a preference for the certainty that fixed fees provide. It is difficult for this business model to absorb the fluctuations which the ASIC fee model may impose. The need for certainty and timeliness, especially in the current pandemic environment, should not be under-estimated. No amount of 'consultation and communication' by way of mitigation is going to change this situation.

We suggest that the current approach of estimating levies in the first half of the year and then invoicing actual levies in December is inherently flawed. This would be like receiving an estimate for a house renovation and then six months later being charged a potentially much higher price and having no option but to pay it. ASIC may not be operating a business but a practical approach to regulating businesses is essential to efficient markets.

Key point: certainty and timeliness should be guiding principles in the structure of the ASIC funding model.

Regulatory overlap

Some of the entities subject to ASIC fees and levies are also regulated by other agencies including the Australian Taxation Office, Tax Practitioners Board, Financial Reporting Council and in the case of professional accountants, by the professional accounting bodies enforcing the Accounting Professional and Ethical Standards Board Code of Ethics. There is also the additional layer of reporting to the Professional Standards Councils. The cumulative regulatory impact should be considered.

For instance, RCAs are subject to a rigorous quality assurance audit every three years by the professional accounting bodies. There is also mandatory Continuing Professional Development and a complaints, investigations and disciplinary process in place. Even though the professional accounting bodies do not have the same legislative enforcement powers as ASIC, the objectives of regulating, improving behaviour and culture, increasing professionalism (including integrity and competence) and serving the public interest are all the same. There is a high level of scrutiny of these regulated entities and they also receive education, guidance and their interests are represented by their respective professional association. This is essentially a co-regulatory model and should be taken into consideration when assessing the required level of regulatory activity.

Key point: fees and charges could be reduced if ASIC took regulatory overlap into consideration. For example, regulatory activities such as 'supervision and surveillance' of certain sectors, are carried out by others to a greater extent than ASIC.

Technology and efficiencies

On the ASIC website, it states: 'As technology rapidly reshapes global financial markets, services and their regulation, ASIC's strategic priority is promoting regulatory technology (regtech) adoption'.

We would expect to see ASIC leading the way in the use of regtech in its own regulatory activities, with a resulting decrease in costs, over time. We note that ASIC also mentions 'suptech' (supervisory technology); and is involved with the Innovation Hub and the regulatory sandbox. All of this should translate to reduced costs and reduced fees and charges on regulated entities.

Key point: there should be more information provided in the CRIS on how ASIC is using technology to reduce regulatory costs, drive efficiencies and improve outcomes.

Competitive pressures

We contend that qualified accountants leaving the financial advice sector is counter-productive at a time when more Australian consumers are seeking affordable and competent financial advice from their choice of trusted adviser. The current pandemic has heightened this need, especially as we see 2.8 million Australians withdraw $25.3 billion from their superannuation under the Government's early access to superannuation measure (APRA website, statistics current as at 12 July 2020).

We are already seeing a gradual and continuing reduction in the numbers of RCAs, SMSF auditors and liquidators. This is evidenced in the ASIC Annual Report 2018-19 (Appendice 8.4 Five-year Summary of Stakeholders key data from 2014-15 to 2018-19 on pages 264-5). In addition, according to our own data, accountants are exiting the financial advice space.

The cost of doing business, including ASIC fees and levies, has added to the pressure on these sectors, especially the smaller practices which cannot easily continue to absorb costs and find it increasingly difficult to pass costs on to clients who are equally embattled. Many IPA members hold multiple registrations which obviously increases the cost of being in business. We believe that the cumulative cost for these, often small, practitioners should be taken into consideration.

Key point: a proportionate levy system would be more equitable; ease anti-competitive pressures; and better serve the public interest. ASIC already collects information to facilitate this system.

RCAs and registered liquidators

As we mentioned in our last CRIS submission, we are unable to understand why liquidators are subject to higher fees and a different fee structure than other sectors such as RCAs who are charged a flat levy. We note that the total costs to be recovered by levy from 651 liquidators is $7.760 million as opposed to $2.569 million from 3,962 RCAs.

We are unable to reconcile the differences in indirect costs between the RCA and liquidator sectors, for instance, 'governance, central strategy and legal' is costed at $0.281 million for RCAs and at $0.937 million for liquidators. 'Property and corporate services' are costed at $0.516 million for RCAs and $0.845 million for liquidators. Given there are over six times as many RCAs as liquidators, these costs would seem disproportionate.

Mandatory legislative requirements mean that liquidators must undertake certain tasks whether they are able to recover the fees or not. We note that between July 2018 and June 2019, for companies entering liquidation: 85% had assets of less than $100,000; 58% had less than $10,000; almost 37% were reported as asset-less; 8.5% had assets over $250,001; and 92% estimated the return to unsecured creditors would be $0. (ASIC Report 645 Insolvency Statistics June 2018-June 2019). We are advised by members who practice as liquidators that up to 80% of their fees are regularly 'written-off' and that they expect this to be offset by other engagements and work.

Given that the number of liquidators is declining in an uncertain and cyclical profession, we contend that a different approach should be considered based on a lower, flat levy.

The insolvency sector is in need of further reform and in this regard, we support the recommendations of the Australian Small Business and Family Enterprise Ombudsman's Insolvency Inquiry Report, released July 2020. In the meantime, we believe that ASIC should be cognizant of the structural inefficiencies in this sector when assessing the fees, charges and levies.

Key point: the methodology and fees imposed on liquidators should be reviewed in light of the structural issues facing this sector.

SMSF auditors

The other sector from which we continue to receive feedback is SMSF auditors. We have commented on this sector in previous submissions, and we are now seeing a continuing decline in the number of SMSF auditors. The impact of market concentration, offshoring, outsourcing, technology, additional regulation and scrutiny, are all taking a toll on this sector. In light of this, we believe that the registration and de-registration fees should be significantly reduced. In particular, having a fee to de-register, when other sectors don't have such a fee, is unnecessarily punitive and even discriminatory according to some members who are seeking to exit the sector.

Key point: this sector continues to face abnormal competitive pressures which should be considered by ASIC in assessing fees and charges.

Small entities

Many smaller entities are low risk and do not require and do not appear to receive much supervision, surveillance or enforcement, which make up the bulk of ASIC's costs.

Key point: the low level of regulatory activity given to this low risk sector, does not justify the level of fees and charges.

Member feedback

We have received numerous and ongoing complaints and comments from our members about the hardships they and their clients are facing during the current pandemic. For some, this started with the recent bushfires and other natural disasters over the last summer. Many are under pressure to either waive or reduce their fees and are faced with small business clients who may not survive the economic downturn.

In this environment we are at a loss to understand the justification for a 38% increase in fees which some of our members with financial services licences have been asked to pay; and this is after a 25% increase last year. Some members have even sent their invoices to us in a state of disbelief. The IPA has heard from many members over the last couple of years who have decided to surrender or think about surrendering their (limited) financial services licence due to a lack of profitability and other reasons. The current downturn has exacerbated their position.

Key point: ASIC fees and levies are considered unreasonable and excessive by many IPA members.

If you have any queries with respect to our submission please don't hesitate to contact Vicki Stylianou at vicki.stylianou@publicaccountants.org.au or on mobile 0419 942 733.

Yours faithfully

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