



The Institute of Public Accountants



IPA INSTITUTE OF PUBLIC
ACCOUNTANTS
Partnership beyond numbers

**Submission to Treasury:
Self-reporting of contraventions
in the financial services industry**

May 2017

IPA - Deakin SME Research Centre

The Institute of Public Accountants (IPA) is one of the three legally recognised professional accounting bodies in Australia. The IPA has been in operation for over 90 years and has grown rapidly in recent years to represent more than 35,000 members and students in Australia and in more than 80 countries. The IPA has offices around Australia and in London, Beijing, Shanghai, Guangzhou and Kuala Lumpur. It also has a range of partnerships with other global accounting bodies. The IPA is a full member of the International Federation of Accountants and has almost 4,000 individual accounting practices in its network, generating in excess of \$2.1 billion in accounting services fees annually. The IPA's unique proposition is that it is for *small business*; providing personal, practical and valued services to its members and their clients/employers. More than 75 per cent of IPA members work directly in or with small business every day. The IPA has a proud record of innovation and was recognised in 2012 by *BRW* as one of Australia's top 20 most innovative companies.

In 2013, the IPA partnered with Deakin University to form the IPA Deakin SME Research Partnership, a first in Australia. This partnership has grown and evolved into the IPA assisting Deakin University in establishing the IPA-Deakin SME Research Centre in 2016. The goal of the Centre is to bring together practitioner insights with cutting edge SME academic research, to provide informed comment for substantive policy development.

The IPA-Deakin SME Research Centre comprises:

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ASIC Enforcement Review
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: ASICenforcementreview@treasury.gov.au

Dear Sir/Madam

Response to Consultation on “Self-reporting of contraventions by financial services and credit licensees”

The Institute of Public Accountants (IPA), which has more than 35,000 members in Australia and across the globe, welcomes the opportunity to respond to Position and Consultation Paper 1: Self-reporting of contraventions by financial services and credit licensees, which is a part of the ASIC Enforcement Review. The IPA has within its membership practitioners that are involved in the provision of financial services and credit-related advice and this response is written with the practical implications for these members in public practice.

It should be noted at the outset that a periodic review of a regulatory structure and its performance is important to ensure that the regulator agency is performing its function effectively and efficiently. The IPA supports this review and its underlying objective of improving the manner in which self-reporting of contraventions takes place. The terms of reference of the ASIC Enforcement Review Taskforce is comprehensive and it is our intention to participate in this process on all matters that are relevant to the IPA as an organisation and its membership base. We look forward to responding to other consultation papers.

We should at the outset state that the current regime for the self-reporting of breaches, lacks the requisite robustness and may result in the provisions of the law being applied in an arbitrary manner. In this sense, concerns about the subjectivity of the regulatory regime are legitimate and should be addressed as soon as practicable. Accounting professionals are taught the value of exercising appropriate professional judgement in various circumstances, but the self-reporting of breaches may require the development of detailed guidelines so that the law is applied in the same manner in each instance. We are conscious of the fact that this may not happen in each case, but more appropriate guidance on how the rules should apply will limit the opportunity for latitude.

There is a further matter requiring consideration. The IPA, in a previous submission to the Federal Government ¹ recommended inter alia, the establishment of a sound foundation for co-regulation.

¹ Institute of Public Accountants (2016) Proposed Industry Funded Model for the Australian Securities and Investments Commission – 16th December 2016, Institute of Public Accountants, Melbourne

There is no evidence that any co-regulatory solution to the issue of self-reporting has been explored despite the fact that the government has sought in the past to seek feedback from professional bodies on regulatory design (including the IPA). This was particularly the case in the context of the corporate regulator. While it is important to draw on experiences of other co-regulatory regimes that operate in countries with similar laws to Australia for external validity purposes, it is also equally prudent to draw on the self-regulatory experiences and expertise that currently exists in the various professional organisations within Australia. In particular, the IPA is amongst a group of organisations in the community that has a disciplinary process that regularly deals with issues surrounding the reporting of breaches in public practice and how best to deal with those issues, including the use of disciplinary action. Our perspectives on a select series of matters from this consultation paper appear in commentary below.

The issue of ‘significance’ (materiality) should be maintained as a criteria for self-reporting

Significance of a particular transaction should be maintained as a criterion for the self-reporting of breaches, but further guidance must be provided so that firms know how the issue of significance is to be interpreted in practice. For example, in statistics, a statistically significant result is one that is unlikely to be the result of chance (usually guided by the conventional 5%, 1% and .01% significance levels, respectively). But sometimes a statistically significant result is not practically significant and is thus trivial in the real world because it has no economic impact. Accordingly, the consultation provides examples of the ways firms use the concept of materiality of a transaction to determine whether such a transaction has economic significance to that particular organisation. In this sense, we are mindful, that there will be occasions where a transaction may be deemed, on average, to be “significant” for self-reporting purposes, but it has no economic significance to a particular organisation and it is these circumstances that the regulator may need to take into consideration.

The Auditing and Assurance Standards Board has a specific auditing standard (ASA 320) dealing with the assessment of materiality in the context of an audit and it offers an example of how to formulate guidance in areas where terms may be used in different ways.² The standard may be useful for the Taskforce to consider as a point of reference in the process of refining the self-reporting of breaches framework. A suggested requirement for triggering the reporting of breaches obligations is what a *reasonable person* would regard as being a significant transaction, but such a test would not necessarily reduce ambiguity in its own right. Again, in our view, further guidance is required which would ensure that there is clarity on how significance should be interpreted. The ultimate goal of this process should be a regime where licensees would come to the same answer on the issue of significance if presented with the same set of facts and circumstances within their own organisation.

The importance of getting the definition right from the outset cannot be underestimated. The term ‘significance’ and any associated guidance will be used by practitioners as the benchmark in determining what constitutes breaches that should be reported.

² Australian Auditing and Assurance Standards Board (2011) Auditing Standard ASA 320 Materiality in Planning and Performing and Audit, Australian Auditing and Assurance Standards Board, Melbourne.

Reporting obligation on licensees should expressly include significant breaches or other significant misconduct by an employee or representative.

Extending the requirements for a licensee to report breaches or misconduct by an employee or representative, may compel a licensee to report matters to ASIC in particular circumstances, but this requirement cannot be predicated on the belief that the licensees will be always be aware of all of the activities being undertaken on their behalf by employees or representatives. Indeed, it is possible that regulatory breaches will occur and the licensee is unaware of these breaches until sometime after the transaction has been executed. In this regard, the extended reporting obligations should be accompanied by protection provisions in the legislation, for example, that licensees are not in breach of the relevant provisions if it is unreasonable to expect them to have detected a breach in a timely manner. Also, there may be practical considerations that need taking into account, such as for example, licensees spending time away from the practice either on personal leave or as a result of illness. In our view, the drafting of any revisions to the law should ensure that the legislation explicitly allows for situations where it is unreasonable to expect timely detection of breaches by licensees. This is especially the case with small licensees and practices. Not all of them have the resources and systems which are available in large(r) licensees which are not as dependent on a 'key person' or persons.

Reporting within 10 business days from the time the obligation to report arises

The consultation paper suggests that licensees should report breaches of misconduct within 10 days (presumably working days) from the time they become aware or have reason to suspect that a breach has occurred, may have occurred, or may occur. This approach circumvents the reporting of breaches in circumstances where the licensees exercise their judgement based on the facts as seen by them that a breach has occurred and is significant. While it would seem these provisions mirror the UK regulator's approach on the issue of breach reporting, there may be a need to ensure that reporting breaches to the regulator are not merely based on the suspicion that a breach may occur. Breach reports can lead to regulatory inquiries depending on the nature of the breach reported. The notion of reporting breaches that 'may occur' could result in reporting matters without sufficient evidence of wrongdoing, and potentially adversely impacting on innocent individuals.

Notwithstanding the above, in circumstances where the evidence is clear that a breach has occurred, a 10-day period during which a breach should be reported by licensees appears to be a reasonable timeframe. Nothing has come to our attention during the preparation of this submission to indicate that the period of time recommended in the consultation paper is inappropriate.

Changing the penalty regime for failure to report as and when required

A penalty regime that provides licensees with a greater incentive to self-report breaches on a timely basis and in accordance with regulatory deadlines, is to be encouraged, within reason. In this regard, one of the options considered is an increase in the maximum criminal penalty. This may assist in elevating awareness amongst licensees that the failure to report on a timely basis has serious consequences. Whilst we believe that it is appropriate for the penalty regime to be re-examined, any changes in a penalty regime must, by necessity, take into consideration the resources available

within ASIC to enforce the various provisions of the law. We envisage that an increase in the nature of criminal penalties will increase the workload of ASIC over time, and further constrain existing resources.

The Taskforce has suggested that there be a civil penalty for failure to report and that there also should be an infringement notice for the failure to report on a timely basis. Regulators should have varying options for enforcement so that they are not merely limited to prosecuting a criminal case. Failing to report a breach that might be considered minor may be more effectively dealt with as a civil matter rather than be treated as a criminal offence.

Cooperative approaches between licensees and the regulator

Encouraging greater cooperation between licensees and the regulator when matters are reported early is appropriate. In our view, there is limited merit in having a situation where the regulator and licensee are in an adversarial relationship in circumstances where the licensee has come across breaches within their own operation. Cooperative approaches with the regulator exist in other areas such as financial reporting and audit and the Taskforce's recommendation it would appear, is an extension of this philosophy which we support.

Prescribing the content of reports and the delivery method

We believe that there should be a *prescribed format* for breach reporting so that reports are prepared in a uniform manner. It is also acknowledged that licensees will have different scales of operations, different numbers of employees, different clients and also different types of transactions. These differences should be taken into account in the drafting of the prescribed reporting format, which will presumably be tabled in the accompanying regulations. In this sense, with a prescribed format along with the proposed requirement that reports be lodged electronically, there would be greater assurance that any breach reports are delivered promptly once a breach has been uncovered.

Credit licensees

There is no reason why credit licensees should not be subjected to the same or similar breach reporting mechanisms. While the credit licensees are regulated by a different regime, it is important that regulations relating to self-reporting breaches are consistent. The AFSL and the credit licensing regime, both deal with regulating the provision of advice on financial arrangements. Thus it would make sense to have a similar breach reporting regime.

Qualified privilege for licensees and the removal of additional reporting requirements

The IPA supports the qualified privilege recommendation as set down in the consultation paper. It is important that licensees are given some legal protection as an incentive to report breaches that have

taken place. Nothing has come to our attention that would suggest the recommendation in the consultation paper should be contended.

Breach reporting and its analysis in ASIC reports

The IPA agrees with the Taskforce's position that there be no identification of licensees or their firms in any reports prepared by ASIC regarding the number and types of breaches that have been reported to the authorities. It would be counterproductive for the self-reporting regime if the names of firms and the individuals against whom a breach was being alleged were to be made public. The consultation paper suggests that there be a focus on confirmed breaches rather than suspected breaches. Suspected breaches may not lead to any enforcement action and as such, from a natural justice perspective, it would be unfair to identify specific persons or organisations on the basis of suspected breaches. Individuals should only be named if there are circumstances where enforcement action is taken.

In some self-reported breach cases, it is also important to consider that such cases could be dealt on a self-remedial basis. For example, in cases where the licensee believes that the nature of the breach is 'marginally material', appropriate remedial action could be taken rather than considering more serious criminal action. In such cases, more training for the individual or the organisation could be considered a more appropriate option to ensure these breaches do not occur again. In these circumstances, naming the person(s) or organisation(s) would be inappropriate.

A good example of the way in which ASIC currently addresses potential problematic trends in fraud behaviour via a reporting mechanism rather than the identifying individuals or organisations, is the successful annual audit inspection reporting program^{3 4}. Annually, the program involves the random selection and inspection of a number of firms and any issues requiring further attention are identified by bringing them to the attention of the community without naming an auditor or an audit firm. A similar approach is taken by the Public Company Oversight Board in the United States⁵ where in 2016, the board reported on the inspection program related to audits of brokers and dealers. The only time the regulator would name an auditor or audit practice would be in circumstances where some form of enforcement had taken place. An example of this form of disclosure where specific persons/firms are identified, is where such parties are required by law to sign an *enforceable undertaking* with the corporate regulator. Similarly, here a regulator's media release may also report the outcome of a Company Auditor's and Liquidator's Disciplinary Board findings. In this sense, no regulatory purpose would be served by naming a firm or individual unless there is an enforcement

³ Australian Securities & Investments Commission (2015) Report 461: Audit inspection program report for 2012-13, Sydney, New South Wales, Commonwealth of Australia

⁴ Australian Securities & Investments Commission (2014) Report 397 for 2012-13, Sydney, New South Wales, Commonwealth of Australia

⁵ Public Company Accounting Oversight Board (2016) PCAOB Release No. 2016-004: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers August 18, 2016, PCAOB, Washington DC

outcome. The same process should be followed in the case of the self-reporting of breaches under the financial services and credit licensing regime.

The IPA has a range of disciplinary processes that have sanctions available (some serious) should a member be found to be in breach of the IPA's professional standards. Sanctions can include naming a member publicly but this would only be undertaken should the circumstances warrant publication. Publication may be counterproductive if the member is encouraged to undertake further training to ensure similar breaches do not occur. Other professional bodies have similar procedures for their members.

If you would like to discuss any of our comments, please don't hesitate to contact me at either vicki.stylianou@publicaccountants.org.au or on 0419 942 733.

Yours faithfully



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