



**ASIC**

Australian Securities & Investments Commission

**REPORT 533**

# **Response to submissions on CP 265 Communicating audit findings to directors, audit committees or senior managers**

June 2017

## **About this report**

This report highlights the key issues that arose out of the submissions received on Consultation Paper 265 *Communicating audit findings to directors, audit committees or senior managers* (CP 265) and details our responses to those issues.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see [Regulatory Guide 260](#) *Communicating findings from audit files to directors, audit committees or senior managers* (RG 260).

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## A Overview/Consultation process

- 1 In [Consultation Paper 265](#) *Communicating audit findings to directors, audit committees or senior managers* (CP 265), we consulted on our proposed criteria for determining which audit findings identified from our review of audit files we would communicate to the directors, audit committees or senior managers of the entities concerned.
- 2 We also proposed to let the board of directors of an audited entity know that we will be reviewing audit files relating to the entity as part of our audit firm inspections.
- 3 This report highlights the key issues that arose out of the submissions received on CP 265 and our responses to those issues.
- 4 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 265. We have limited this report to the key issues.

### Responses to consultation

- 5 We received 10 non-confidential and 2 confidential responses to CP 265 from larger accounting firms, professional accounting bodies, the Australian Institute of Company Directors (AICD), and Group of 100. We are grateful to respondents for taking the time to send us their comments.
- 6 For a list of the non-confidential respondents to CP 265, see the appendix. Copies of these submissions are currently on the ASIC website at [www.asic.gov.au/cp](http://www.asic.gov.au/cp) under CP 265.
- 7 During and after the formal public consultation period, we undertook verbal consultation with the large audit firms, accounting bodies, audit committees, AICD and other interested stakeholder groups, to obtain more detailed feedback on some of the criteria in the proposal.
- 8 Most respondents were generally supportive of our rationale and criteria for communicating findings from audit file reviews; however, the main feedback was that our criteria for communicating matters should be more objective, and that we should provide more detail on our timing and process for communicating findings. We have considered this feedback when drafting RG 260.
- 9 The main matters raised by respondents concerned:
  - (a) making our criteria for communicating matters to audit committees more objective, and defining the term ‘relative severity’ used in the criteria;

- (b) providing more detail on how and when we will communicate matters from audit file reviews to audit committees, directors or senior managers;
- (c) providing more clarity about whether our ability to report financial reporting and audit quality findings under s127 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act) is separate from our ability to issue an audit deficiency report under s50C of the ASIC Act;
- (d) providing guidance for directors on their response to matters communicated by ASIC; and
- (e) the possibility that privileged information provided by the auditor may be disclosed to the entity in circumstances where ASIC intends to take potential enforcement action, and the potential damage this could cause the auditor.

10 [RG 260](#) incorporates the feedback received on [CP 265](#) and additional feedback received after the consultation period.

## B Communicating financial reporting and audit quality findings

### Key points

This section outlines the responses we received to our proposal to publish the criteria for disclosing financial reporting and audit findings to directors, audit committees or senior managers of companies, responsible entities or disclosing entities (entities).

It covers feedback on the specific criteria set out in CP 265 and whether we should provide additional guidance about how these criteria apply.

This section also contains our response to this feedback.

- 11 In [CP 265](#), we proposed criteria for communicating financial reporting and audit findings from our review of an audit file to directors, audit committees or senior managers of entities. We also proposed releasing a regulatory guide to set out and explain how the following criteria for communicating these findings will apply:
- (a) we have significant concerns that the financial statement may be materially misstated;
  - (b) the auditor has failed to obtain reasonable assurance that the financial report is free of material misstatement;
  - (c) our concerns about audit quality from previous years have not been addressed by the auditor;
  - (d) the auditor has not met independence requirements; and
  - (e) we plan to take enforcement action against the auditor.
- 12 There were no significant comments from respondents on our criteria for communicating concerns that the financial statements may be materially misstated.

### Criteria for communicating findings

- 13 In CP 265 we proposed to communicate financial reporting and audit quality matters to directors, audit committees or senior managers when particular criteria are met.
- 14 Respondents asked us to:
- (a) apply more objective criteria for communicating audit quality matters, and define the term ‘relative severity’ used in one of the proposed criteria;

- (b) provide separate criteria for communicating financial reporting matters identified from our review of an audit file;
- (c) not communicate the auditor's confidential information from audit files when communicating financial reporting matters; and
- (d) outline both the process we will follow with an auditor before we communicate any findings; and the timing of this communication.

*ASIC's response*

We have implemented our guidance in [RG 260](#).

We have not made our criteria for communicating audit quality matters more objective as a decision about whether to communicate requires judgement that considers all of the facts and circumstances. The criteria are sufficiently clear and linked to the auditing standards: see RG 260.24.

We have explained how 'relative severity' will be assessed when determining whether audit quality findings will be communicated to the entity: see RG 260.24(a).

We have ensured that our criteria for reporting financial reporting matters is clearly separated from the criteria for communicating audit quality matters: see RG 260.21 and RG 260.24.

We have clarified that, when we communicate financial reporting matters, we will not refer to auditor's confidential information on the audit file, except as outlined in RG 260.22.

We have outlined the process we will follow before communicating any findings to the entity, and the timing: see Section C of RG 260.

### **Addressing findings from previous years**

- 15 In [CP 265](#) we proposed to communicate audit quality findings where we have identified that:
- (a) an auditor did not obtain reasonable assurance that an entity's financial report was free of material misstatement in a previous year; and
  - (b) our follow-up review reveals that our concerns have not been addressed.
- 16 The respondents were largely supportive of this proposal. Some felt that more clarification should be provided about how we determine which findings are particularly significant, and the timing of our communication.

*ASIC's response*

We have implemented our guidance in RG 260. The significance of findings is covered in RG 260.24(a).

We have outlined the process we will follow before communicating any findings to the entity and the timing: see Section C of RG 260.

## Assessment of independence requirement

- 17 In [CP 265](#) we proposed to communicate to directors, audit committees or senior managers where we have concerns that the auditor does not meet the independence requirements of the *Corporations Act 2001* (Corporations Act), has not addressed the matter, and has not communicated the matter to the directors or in the auditor's required independence declaration.
- 18 The respondents were largely supportive of this proposal; however, some felt that it is not warranted, given that ASIC already has the established powers to act when the auditor is not independent, and the auditor is also required to confirm its independence in writing with the directors. However, it was generally agreed that, where the auditor fails to meet these requirements, it is appropriate for ASIC to communicate this to the directors.

### *ASIC's response*

We have implemented our proposal in [RG 260](#).

## Potential enforcement action

- 19 In CP 265 we proposed to communicate audit quality and other findings where we intend to take enforcement action against an entity's auditor, but the matter cannot be dealt with in the short term through the Company Auditors Disciplinary Board or through the court. In those circumstances, and taking particular facts into account, we may inform the directors, audit committee or senior managers of the entity so that they can consider appropriate action, such as seeking the resignation or removal of the auditor.
- 20 Respondents were not supportive of this proposal and recommended that we remove it from the regulatory guide. In particular, they raised concerns about:
- (a) how we will allow auditors appropriate opportunity to respond to our findings before communicating to the entity; and
  - (b) whether we should share with directors, audit committees or senior managers information that may be subject to legal privilege that the auditor has provided in response to ASIC's findings.

### *ASIC's response*

We have implemented this proposal in [RG 260](#).

We have stated that we may report findings to directors but may not indicate whether we intend to take enforcement action: see [RG 260.29](#).

We have outlined the process we will follow before communicating any findings to the entity and the timing: see [Section C of RG 260](#).

## C Advising directors of audit file reviews

### Key points

This section outlines the responses we received to our proposal to inform an entity's board of directors know that we will be reviewing audit files relating to the entity:

- as part of a routine audit firm inspection; and
- as part of a surveillance activity where we already have reasons for concern about the adequacy of the audit.

It also outlines our response to this feedback.

### Guidance on rationale and timing

- 21 In [CP 265](#) we consulted on a proposal to inform an entity's board of directors that we will be reviewing audit files relating to the entity as part of an audit firm inspection or audit surveillance activity.
- 22 The respondents were largely supportive of this proposal.

#### *ASIC's response*

[RG 260](#) states that we will inform an entity's board of directors that we will be reviewing audit files relating to the entity.

## Appendix: List of non-confidential respondents

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- Australian Institute of Company Directors
  - BDO Australia
  - Chartered Accountants Australia and New Zealand
  - CPA Australia
  - Deloitte Touche Tohmatsu
  - Ernst & Young Australia
  - Group of 100
  - KPMG Australia
  - Nexia Australia
  - Pitcher Partners Australia
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