



**ASIC**

Australian Securities & Investments Commission

CONSULTATION PAPER 49

# **CLERP 9: Auditor and financial reporting obligations**

April 2004

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### **Your comments**

**You are invited to comment on the proposals and issues for consideration in this paper, including the explanation sections.**

**Comments are due by 18 May 2004 and should be sent to:**

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**You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.**

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# What this policy proposal is about

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**1** The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (the CLERP 9 Bill) creates new:

- (a) obligations for auditors in the financial reporting provisions in Chs 2M, 5C and 7 of the *Corporations Act 2001* (the Act), which are contained in Schedule 1 of the CLERP 9 Bill, and referred to throughout this policy proposal as the ‘auditor obligations’; and
- (b) financial reporting obligations, which are contained in Schedule 2 (Pts 1 and 2) and Schedule 5 of the CLERP 9 Bill, and referred to throughout this policy proposal as the ‘financial reporting obligations’.

**2** This policy proposal discusses:

- (a) the effect of the auditor obligations and financial reporting obligations on our existing policy statements and practice notes, referred to throughout this policy proposal as ‘policies’ or ‘policy publications’ (**Section A**); and
- (b) how we will apply our general policy on relief to the auditor obligations and financial reporting obligations (**Section B**).

**3** The **Schedule** to this policy proposal summarises in table form the effect of the CLERP 9 Bill on our existing policy publications dealing with auditor obligations and financial reporting obligations.

**4** This policy proposal does not discuss:

- (a) auditor registration provisions, including powers to impose conditions on auditor registration and annual statement requirements (these are discussed in our policy proposal paper *Auditor registration*;
- (b) auditor rotation obligations—we expect to commence policy work on this topic in 2005, as the auditor rotation obligation is currently not scheduled to commence until

the first financial year that begins on or after 1 July 2006;

- (c) auditor independence obligations (other than in the context of our general policy on relief); or
- (d) any specific aspects of the financial reporting obligations—at this stage, we do not consider that it is necessary for us to provide guidance on the financial reporting obligations, other than how we will treat any applications for relief (see **Section B**).

**5** This paper is part of a series of CLERP 9 policy publications and should be read in conjunction with *Building the CLERP 9 Administrative Framework—Policy to implement the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003: An ASIC guide*, February 2004 (the CLERP 9 Administrative Framework Guide).

**6** We do not expect the CLERP 9 Bill to commence until 1 July 2004 at the earliest. Further, Schedule 12 in the CLERP 9 Bill contains various transitional provisions. In many cases the new auditor obligations and financial reporting obligations will not commence until the first financial year that begins on or after 1 July 2004. However, the obligations in the CLERP 9 Bill dealing with reporting of certain matters to ASIC by auditors will apply from 1 July 2004.

**7** ASIC will amend the existing policies referred to in this paper in finalising its policy proposals set out below. Therefore, a final policy statement may not be issued as a result of this paper.

**Important note:** This paper is based on the CLERP 9 Bill as introduced into Parliament on 4 December 2003. It refers to proposed amendments to the Corporations Act set out in the CLERP 9 Bill. This paper is not final ASIC policy. The timing and content of ASIC's policy and other publications depends on the timing of the CLERP 9 Bill's progress through Parliament and whether amendments are made to it during the legislative process.

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# Policy proposals

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In this paper we have two sections:

- (a) **Section A** discusses how the CLERP 9 auditor obligations and financial reporting obligations will affect our existing audit and financial reporting policy publications.
- (b) **Section B** discusses our general approach to relief from the CLERP 9 auditor obligations and financial reporting obligations.

The **Schedule** includes a summary of those policy publications that will be affected by the CLERP 9 auditor obligations and financial reporting obligations.

For each section, we set out the proposals and identify issues we would like you to comment on. Where necessary, we have also included explanations of our proposals.

**Special note:** There may be other issues that you consider important. We are keen to hear from you on our general approach and any other issues you consider important, as well as your answers to our specific questions.

## A Our review of existing policies

Policy proposal	Your feedback
<p><b>Our approach</b></p> <p><b>A1</b> We are reviewing our existing policies to determine their status in light of the CLERP 9 auditor obligations and financial reporting obligations. The tables in the Schedule set out our proposed position on specific policies.</p> <p><b>A2</b> Where the old Act continues to apply, we will continue to apply our existing published policies and guidance.</p>	<p><b>A1Q1</b> Are there any ASIC policies or guidance not identified in the Schedule for which you believe we should provide guidance about their ongoing status? If yes, what are they?</p>
<p><b>Our general principles in determining policy status</b></p> <p><b>A3</b> We will continue to apply policy about provisions that correspond to provisions in the CLERP 9 Bill except as set out in this paper.</p>	<p><b>A3Q1</b> Are there any comments in the Schedule that you disagree with? If yes, briefly explain why.</p>
<p><b>Separate reviews</b></p> <p><b>A4</b> We will conduct a separate review of some policies to determine whether further policy guidance is required as a result of significant changes in the CLERP 9 Bill or other legislative change.</p> <p><b>A5</b> Policies we will separately review are:</p> <ul style="list-style-type: none"> <li>(a) Practice Note 34 <i>Auditors' obligations</i> [PN 34];</li> <li>(b) Policy Statement 43 <i>Accounts and audit relief</i> [PS 43]; and</li> <li>(c) Practice Note 68 <i>New financial reporting and procedural requirements</i> [PN 68].</li> </ul>	<p><b>A5Q1</b> Are there any other policies that should be separately reviewed as a result of the CLERP 9 auditor obligations and financial reporting obligations? If yes, what are they and why do they require separate review?</p>

Policy proposal	Your feedback
<p><b>Auditors' obligations [PN 34]</b></p> <p><b>A6</b> Auditors must report significant suspected contraventions of the Act to ASIC. An auditor is also required to report a contravention that is not significant, if the auditor believes that the contravention has not been or will not be adequately dealt with by commenting on it in the auditor's report or bringing it to the attention of the directors.</p> <p><b>A7</b> The CLERP 9 Bill includes factors that an auditor must have regard to in determining whether a suspected contravention is a significant one: see cls 311(4) and 601HG(10) of the Bill. The Explanatory Memorandum to the CLERP 9 Bill also includes some issues that could be considered in determining whether a contravention is significant.</p> <p><b>A8</b> An auditor must also have regard to any 'other relevant matters' in determining whether a contravention of the Act is a significant one and so should be reported. These should be determined by the auditor having regard to all the facts and circumstances of the particular situation. To provide some guidance, we have listed factors that we believe an auditor should consider. These include:</p> <ul style="list-style-type: none"> <li>(a) whether contraventions of the same or similar nature occur in more than one area of the audited body (where an area might include a different department, segment or discrete unit of management);</li> <li>(b) whether the contraventions are systemic, multiple or continuing;</li> <li>(c) the seniority of the people involved in the contravening conduct (e.g.</li> </ul>	<p><b>A8Q1</b> Is more guidance required to assist an auditor to determine if a contravention is significant? If yes, briefly explain why and on what aspects.</p>



Policy proposal	Your feedback
<p>officers or senior managers); and</p> <p>(d) whether the audited body or any of its officers or senior managers have previously contravened the Act by engaging in similar conduct.</p> <p><b>A9</b> This list of factors is not exhaustive. It should not be used as a checklist. It is the auditor's responsibility to decide if a suspected contravention is significant. If the auditor has any doubt about whether a contravention is significant or not, the auditor should report the suspected contravention to ASIC.</p> <p><b>A10</b> At this stage, we will not provide guidance on an auditor's obligation to report an attempt to unduly influence, coerce, manipulate or mislead a person involved in the conduct of the audit.</p>	<p><b>A10Q1</b> Is more guidance required to assist auditors in this regard? If yes, briefly explain why and on what aspects.</p>

# Explanation

## Our approach

**1** Our aim is to give certainty to industry by clarifying how our existing policy publications under the Act will apply under the CLERP 9 Bill. The tables in the Schedule are based on our review of significant policies about audit and financial reporting requirements, and our general approach to relief. Unless there is reason for change, we will apply as much of our previous published policy and guidance as we can.

**2** If a policy publication is not referred to specifically in this policy proposal or in the Schedule, you should assume that it continues to apply.

**3** Where necessary, we will amend our existing class orders and execute any new class orders to give effect to our policy proposals and to reflect any incidental changes that are made by the CLERP 9 Bill.

## Separate reviews

**4** We will conduct a separate review of Practice Note 34 *Auditors' obligations* [PN 34]; Policy Statement 43 *Accounts and audit relief* [PS 43]; and Practice Note 68 *New financial reporting and procedural requirements* [PN 68]. We will comprehensively review these policies. This review will consider changes needed because of CLERP 9, and also whether other changes might be needed, such as the need to take account of new accounting standards (e.g. AASB 1046 on directors' remuneration).

**5** We do not anticipate making major changes to our fundamental policy on relief set out in [PS 43]. However, we will make changes necessary to take account of any legislative amendments (including those proposed in the CLERP 9 Bill) and case law since [PS 43] was last updated in 1996. We will issue a revised version of [PS 43] before July 2004. The revised [PS 43] will include CLERP 9-specific changes needed as a result of this policy proposal paper.

## Auditors' obligations [PN 34]

**6** The Explanatory Memorandum to the CLERP 9 Bill recognises:

‘[T]he important role that auditors play as the principal external check on the veracity of companies’ financial statements. As such, auditors are in a unique position to determine whether there has been a contravention of the law. The provisions harness the role of auditors by encouraging the timely disclosure of possible breaches of the law’: para 5.242.

**7** The current drafting of s311 of the Act does not require an auditor to report a suspected contravention of the Act to ASIC if the auditor believes the contravention will be adequately dealt with by commenting on it in the auditor’s report or bringing it to the attention of the directors. This provision will be repealed from the commencement of the CLERP 9 Bill and replaced with a new provision.

**8** The new cl 311 and the amendments proposed to s601HG and s990K of the Act create important new obligations for auditors. These obligations are to report:

- (a) suspected significant contraventions of the Act;
- (b) contraventions that are not significant where the auditor believes that they have not or will not be adequately dealt with by commenting on it in the auditor’s report or bringing it to the attention of the directors (replicates the existing s311(1)(b)); and
- (c) any attempt to mislead or coerce a person involved in the audit.

**9** [PN 34] already provides some guidance on contraventions that are not significant where the auditor believes that they have not or will not be adequately dealt with by commenting on it in the auditor’s report or bringing it to the attention of the directors.

**10** Clauses 311(4) and 601HG(10) of the CLERP 9 Bill include factors that an auditor must have regard to in determining whether a contravention is a significant one. These factors are:

- (a) the level of penalty for the contravention;
- (b) the effect that the contravention has, or may have, on:
  - (i) the overall financial position of the company, registered scheme or disclosing entity; or
  - (ii) the adequacy of the information available about the overall financial position of the company, registered scheme or disclosing entity; and

- (c) any other relevant matter.

**11** The Explanatory Memorandum to the CLERP 9 Bill also includes some issues that could be considered in determining whether a contravention is significant, including:

- (a) insolvent trading by the company;
- (b) a breach of accounting standards or the true and fair view requirement;
- (c) a breach of Div 2 Pt 2 of the ASIC Act;
- (d) suspected dishonest or misleading and deceptive conduct; and
- (e) a breach that may cause a significant loss to any person or class of persons.

**12** We think that it is important for us to provide guidance on how we will assess compliance with the obligation to report to us any significant contravention of the Act, in addition to the factors listed in the CLERP 9 Bill and Explanatory Memorandum. If an auditor has any doubt about the significance of a suspected contravention, the auditor should report it to us. The auditor has qualified privilege for any report made to us in accordance with the current s601HG, and cls 990L or 1289.

## B Our general policy on relief

Policy proposal	Your feedback
<p><b>Our approach</b></p> <p><b>B1</b> We will apply our existing policy on relief as set out in Policy Statement 43 <i>Accounts and audit relief</i> [PS 43] when considering applications under s340 and 341 for relief from the auditor obligations and financial reporting obligations that are introduced into Ch 2M of the Act by the CLERP 9 Bill.</p> <p><b>B2</b> We can only grant relief if at least one of the conditions in s342(1) has been satisfied. We will also take into account whether:</p> <ul style="list-style-type: none"> <li>(a) strict compliance with the requirements of the CLERP 9 Bill would be impossible or disproportionately burdensome; and</li> <li>(b) investors would still have the protection they were intended by Parliament to have if relief were granted.</li> </ul> <p><b>How to apply for relief</b></p> <p><b>B3</b> See Policy Statement 51 <i>Applications for relief</i> [PS 51] for guidance on how to frame your application.</p> <p><b>B4</b> Your application should also candidly set out all information that may be relevant to consideration of the application.</p> <p><b>B5</b> If your application does not contain all the relevant information, we may refuse it unless we consider in the circumstances that we should delay consideration until further information is provided.</p>	<p><b>B2Q1</b> Are there any additional factors that we should take into account? If yes, briefly explain why.</p>

# Explanation

## Our approach

**1** We will not exercise our power to grant relief from any provision in Ch 2M in a way that is inconsistent with Parliamentary intention. Any exercise of power has to be justified by the net benefits that will arise. We will carefully consider any impact of relief on investor protection and shareholder participation. We will also take into account whether relief will result in any commercial advantage or disadvantage.

**2** We exercise our powers based on as much information as can reasonably be attained. You are better placed than us to get the most relevant information such as quantifications of costs and benefits. It is appropriate that you do so if you choose to seek the benefit of relief.

**3** To exercise our power in s340 or 341 of the Act, we must be satisfied that complying with the relevant requirements would:

- (a) make the financial report or other reports misleading; or
- (b) be inappropriate in the circumstances; or
- (c) impose unreasonable burdens.

**4** An application under s340 of the Act for specific relief must be authorised by a resolution of directors of the audited company and be made in writing and signed by a director.

**5** We take the view that complying with the auditor obligations and the financial reporting obligations would only be ‘inappropriate in the circumstances’ if:

- (a) there is an anomaly in the Act; or
- (b) compliance would give rise to consequences not intended by Parliament.

**6** We take the view that complying with these obligations would only impose ‘unreasonable burdens’ if:

- (a) burdens would be associated with complying or would result from having complied with those obligations; and
- (b) those burdens are disproportionate to the benefits that would accrue through compliance.

**7** Whether a burden may be fairly described as unreasonable is a question of fact requiring an evaluation of the evidence, having regard to the nature of the requirement to be performed, and keeping in mind

the policy objective of that requirement. The fact that compliance with the Act will involve additional costs does not, in itself, satisfy the unreasonable burden precondition.

Note: See [PS 43] for further details about when we can provide relief under s340 or 341 of the Act.

## How to apply for relief

**8** Applications need to address why relief would save costs or otherwise provide commercial benefits. Applications must also address the effects of the relief on others, in particular investors. This approach reflects that adopted in Policy Statement 51 *Applications for relief* [PS 51].

# Schedule: Tables of affected policies

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This Schedule shows how existing ASIC policy publications will apply under the CLERP 9 Bill once the relevant parts of the CLERP 9 Bill commence. The tables in this Schedule deal with:

- ASIC policy statements (Table 1); and
- ASIC practice notes (Table 2).

This Schedule deals only with audit and financial reporting-related policies.

The Schedule is based on the CLERP 9 Bill as introduced into Parliament on 4 December 2003. Statements in the Schedule may need to be revised in light of any amendments made to the CLERP 9 Bill during its passage through Parliament and the making of any regulations.

Some policies apply definitions that relate to the old Act. The CLERP 9 Bill changes some definitions, which will result in the policy having to be applied with necessary adaptations.

**Table 1: ASIC policy statements affected by CLERP 9**

Number	Description	Effect of CLERP 9 Bill
26	<i>Resignation of auditors</i>	This policy will continue to apply (with any necessary adaptations).
43	<i>Accounts and audit relief</i>	This policy will continue to apply (with any necessary adaptations) until we have completed a separate review. Interim policy statement 174 <i>Externally administered companies: financial reporting and AGMs</i> also provides guidance on granting relief under Ch 2M.
115	<i>Audit relief for proprietary companies</i>	This policy will continue to apply (with any necessary adaptations).
136	<i>Managed investments: discretionary powers</i>	Paragraphs [PS 136.40]–[PS 136.41], [PS 136.44] and [PS 136.62]–[PS 136.66] dealing with resignation of auditors will continue to apply.



**Table 2: ASIC practice notes affected by CLERP 9**

Number	Description	Effect of CLERP 9 Bill
22	<i>Directors' statement as to solvency</i>	<p>This guidance will continue to apply.</p> <p>[PN 22.13] must be read in the light of the auditor's obligations under s311(1) and 601HG(4) as amended by the Bill.</p>
34	<i>Auditors' obligations</i>	<p>This guidance will continue to apply until we have completed a separate review.</p>
68	<i>New financial reporting and procedural requirements</i>	<p>This guidance will continue to apply until we have completed a separate review.</p> <p>[PN 68.51]–[PN 68.63] should be read in light of the amendments proposed in Schedule 5 of the CLERP 9 Bill (including the proposed new definitions of a 'company executive' and 'relevant group executive'). Defined terms such as 'officer' and 'executive officer' should be read in light of the amendments to those definitions, and the insertion of new definitions of a 'senior manager' proposed in Pt 3 of Schedule 1 and of 'group executives' proposed in Schedule 9 of the CLERP 9 Bill.</p> <p>[PN 68.78]–[PN 68.79] should be read in light of the amendments to s295(4) and 303(4) proposed in Schedule 11 of the CLERP 9 Bill.</p> <p>[PN 68.131]–[PN 68.133] should be read in light of the amendments to the form and delivery of notice of a meeting to members proposed in Schedule 8 of the CLERP 9 Bill.</p>

# Regulatory and financial impact

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We have considered the regulatory and financial impact of the policy proposals in this paper. Based on the information currently available to us, we believe that implementing the proposals will strike an appropriate balance between facilitating the credibility and reliability of financial reporting and corporate disclosures (including by listed companies) and investor protection.

So that we can more fully assess the financial and regulatory impact of our proposals, in seeking your views we specifically invite you to comment on:

- (a) the likely financial impact of the proposals, including the impact on small business and existing registered company auditors; and
- (b) whether the proposals provide sufficient investor protection, including the extent to which the proposals affect the reliability and credibility of financial statements.

# Development of policy proposal

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We have developed this policy proposal paper by considering:

- (a) the *Corporate disclosure: strengthening the financial reporting framework* discussion paper issued by Treasury in September 2002 and submissions received in response to that discussion paper;
- (b) a review of the Exposure Draft CLERP 9 Bill and public submissions made in response to that Bill;
- (c) a review of transcripts of public hearings held as part of the inquiry into the Exposure Draft CLERP 9 Bill by the Parliamentary Joint Committee on Corporations and Financial Services;
- (d) the Explanatory Memorandum to the CLERP 9 Bill and the Second Reading Speech in the House of Representatives on the introduction of the CLERP 9 Bill into Federal Parliament and subsequent Parliamentary debate about the CLERP 9 Bill; and
- (e) a review of existing ASIC policies and practices relevant to the regulation of auditors and financial reporting under the Act.

# Key terms

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In this policy proposal, terms have the following meaning:

**Act** The *Corporations Act 2001* (Cth).

**ASIC** Australian Securities & Investments Commission.

**ASIC Act** The *Australian Securities and Investments Commission Act 2001* (Cth).

**auditor** This means:

- (a) a registered company auditor; or
- (b) an authorised audit company.

**auditor obligations** The financial reporting provisions in Chs 2M, 5C and 7.

**clause 601HG** or **cl 601HG** (for example) A clause of the CLERP 9 Bill (in this example cl 601HG).

**CLERP 9 Administrative Framework Guide** *Building the CLERP 9 Administrative Framework: Policy to implement the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003—An ASIC guide*, February 2004.

**CLERP 9 Bill** or **Bill** The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, as introduced into the House of Representatives on 4 December 2003.

**Exposure Draft CLERP 9 Bill** The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, as published by Treasury on 8 October 2003.

**financial reporting obligations** The financial reporting provisions in Pts 1 and 2 of Schedules 2 and 5 of the CLERP 9 Bill.

**old Act** The Act immediately before amendment by the CLERP 9 Bill.

**[PN 34]** (for example) An ASIC practice note (in this example numbered 34).

**policies** or **policy publications** ASIC policy statements and practice notes.

**[PS 43]** (for example) An ASIC policy statement (in this example numbered 43).

**s311** (for example) A section of the Act (in this example, numbered 311).

# What will happen next?

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## Stage 1

5 April 2004

ASIC policy proposal paper released

## Stage 2

18 May 2004

Comments due on the policy proposal

## Stage 3

23 June 2004

Policy finalised

**Important note:** The timing and content of ASIC's policy and other publications depends on the timing of the CLERP 9 Bill's progress through Parliament and whether amendments are made to it during the legislative process.

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### Your comments

You are invited to comment on the proposals and issues for consideration in this paper.

Comments are due by 18 May 2004 and should be sent to:

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You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.

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# Related policy proposal papers

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This policy proposal paper is part of a set of CLERP 9 policies, including the CLERP 9 Administrative Framework Guide issued in February 2004, the policy proposal paper *Licensing: managing conflicts of interest* issued in October 2003 and three policy proposal papers issued together in April 2004 on the implementation of the CLERP 9 Bill. As outlined in the CLERP 9 Administrative Framework Guide, we will issue further proposal papers and guides in the coming months on the implementation of the CLERP 9 Bill.

The other CLERP 9 policy proposal papers issued as at 5 April 2004 are:

- policy proposal paper *Product disclosure*; and
- policy proposal paper *Auditor registration*.

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# To find out more about CLERP 9

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## Keep up to date through our website

Go to [www.asic.gov.au/clerp9](http://www.asic.gov.au/clerp9) for the latest information about CLERP 9.

## Email us for general inquiries

Email your general inquiries about our plans to implement the CLERP 9 Bill to [CLERP9@asic.gov.au](mailto:CLERP9@asic.gov.au). These inquiries are allocated to people best placed to answer them. We will aim to respond to your inquiries as soon as we can.

## Use professional bodies, industry associations and consumer groups

We also suggest that you channel inquiries and comments through your professional body, industry association or a relevant consumer group. We are working closely with a number of these bodies in preparing to administer the new regime. These bodies act as a central point for collecting information and questions on how the CLERP 9 Bill will affect members of each group. It makes sense for us to use them as a way of communicating with each other.