

10 February 2022

Mr Doug Niven
Chief Accountant
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2001

Email: auditsubmissions@asic.gov.au

Dear Doug,

ASIC Consultation Paper 352 Communicating audit findings to directors, audit committees or senior managers

We welcome the opportunity to provide the Australian Securities and Investments Commission (ASIC) with our views on Consultation Paper 352 *Communicating audit findings to directors, audit committees or senior managers*.

Nexia Australia Pty Ltd represents the six independent chartered accounting firms comprising the Nexia Australia network with providing accounting, assurance, tax, and consulting services to small to medium enterprises, large private companies, not-for-profit entities and listed public companies.

ASIC proposes to communicate audit quality findings to directors of an audited company, responsible entity or disclosing entity as outlined in paragraph 11 of RG 352 and to revise RG 260 accordingly.

Our responses to ASIC's specific proposals are subject to the following comments.

The objective of an audit is to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework¹. To obtain reasonable assurance, the auditor exercises professional judgement in planning and performing an audit in order to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion².

Professional judgement is essential to the proper conduct of an audit. Professional judgement is necessary in making decisions about:

- i) Materiality and audit risk;
- ii) The nature, timing, and extent of audit procedures used to meet the requirements of the Australian Auditing Standards and gather audit evidence;
- iii) Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the Australian Auditing Standards and thereby, the overall objectives of the auditor;

¹ ASA 200 para 11(a)

² ASA 200 paras 16-17

Nexia Australia Pty Ltd

Level 16, 1 Market Street
Sydney NSW 2000
PO Box H195
Australia Square NSW 1215
p +61 2 9251 4600
f +61 2 9251 7138
e info@nexiaaustralia.com.au
w nexia.com.au

- iv) The evaluation of management's judgements in applying the entity's applicable financial reporting framework; and
- v) The drawing of conclusions based on the audit evidence obtained.³

ASIC's 2021 Audit Inspection Report states "a negative finding is where auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement (negative findings). Negative findings from our reviews of audits do not necessarily mean that the financial reports audited were in fact materially misstated. Rather, in our view, the auditor did not have a sufficient basis to support their opinion on the financial report"⁴.

However, we note that on specific audit engagement inspections, ASIC's findings are communicated using different language. In our experience, individual inspection findings are described as "the auditor did not obtain reasonable assurance that [account balance or class of transactions] was free of material misstatement", rather than "the auditor did not obtain reasonable assurance that the financial report as a whole was free of material misstatement". Use of different language can cause confusion as to whether the financial statements as a whole are not free of material misstatements (potentially a more pervasive deficiency) than in respect of a specific account balance, financial statement disclosure, or class of transactions.

We request that where ASIC opines that "the auditor did not obtain reasonable assurance that [account balance or class of transactions] was free of material misstatement" and/or "that the auditor did not perform sufficient appropriate audit procedures" (including sample sizes), it also describes or explains what specific audit procedures ASIC expected the auditor to perform, or establish what it believes is an appropriate audit methodology, to satisfy Australian Auditing Standards.

In the absence of such explanation, ASIC inspection findings have the potential to become a debate between two subjective views – the professional judgment and opinion of ASIC and those of the auditor. ASIC acknowledges this can be an issue in each of the large firms' individual inspection reports, noting "The firm did not agree with all of our findings".

In our opinion, a debate of professional opinions on the concepts and application of principles-based Auditing Standards is unlikely to assist directors and audit committees understand whether audit deficiencies have actually occurred.

Nexia is committed to improving audit quality and is transparent with clients subject to ASIC audit inspections. We are not opposed to ASIC communicating audit inspection findings to directors. However, to improve clarity and assist directors, we believe that it would be helpful for ASIC to re-examine its audit inspection approach before ASIC implements its proposals to:

- i) Differentiate findings into areas of:
 - a. judgment or opinion (subjective findings), which may include matters relating to the adequacy of audit file documentation (notwithstanding that additional corroborative evidence may exist outside the audit file); and
 - b. those that are objective errors or deficiencies (objective findings);
- ii) Clearly articulate the basis and reasons for ASIC making its finding and, importantly, what actions or procedures the auditor should have performed to address the matter; and
- iii) Ensure that different language or thresholds are not used between its reporting on individual file inspections and that used in its annual Audit Inspection Report.

³ ASA 200 para A26

⁴ ASIC REP 709, page 3

The following specific responses to ASIC's questions should be read in this context.

B1Q1 Should any of the types of audit quality findings outlined in paragraph 11 not be communicated?

11(a) we have formed the view that an auditor has not obtained reasonable assurance that an entity's financial report is free of material misstatement.

We do not oppose ASIC communicating such matters. However, where such a finding is made, we also suggest that ASIC clearly articulate:

- i) the basis and reasons for ASIC forming that view;
- ii) what actions or audit procedures it believes should have been performed to address the matter; and
- iii) whether those findings are subjective or objective.

Refer also comments above.

11(b) although reasonable assurance was obtained that the financial report for the current year was free of material misstatement, we consider that audit work should be improved in future years.

We disagree with the proposal.

RG 260.24 attached to CP 352 states "Our criteria in RG 260.23 [Para 11 of CP 352] are based on the objective of an audit — as set out in the auditing standards having the force of law under the Corporations Act — that is, to obtain reasonable assurance that a financial report is free of material misstatement. The auditing standards provide a framework to support the application of our criteria and are the basis we use for measuring audit quality".

If ASIC is satisfied that the auditor has obtained reasonable assurance that the financial report as a whole is free of material misstatement, then any further comment regarding potential improvements may be misinterpreted by directors that deficiencies exist and audit quality is impaired.

We welcome ASIC communicating its best practice experiences and suggestions for enhancing audit quality to the auditor, but we believe the potential disadvantages outweighs any potential advantages in communicating such matters to company directors.

11(c) we have concerns that the auditor did not meet the independence requirements of the Corporations Act (including professional requirements), has not addressed the matter, and has not adequately reported the matter in an auditor's independence declaration.

We disagree with the proposal.

In our opinion, the statement – "we have concerns that the auditor did not meet independence requirements" - is vague and subjective. A shopping list of items *could* be identified as areas of potential independence 'concerns'. However, this may result in auditors and directors incurring time and resources responding to ASIC's potential concerns that may either have been previously resolved or are, in fact, non-existent.

Rather, we suggest that ASIC should only report where it has objectively determined that the auditor did not meet its independence requirements, has not addressed the matter, or has not adequately reported the matter in an auditor's independence declaration.

11(d) we consider any other matter should be drawn to the attention of the directors or audit committee of the audited entity.

We note that draft RG 260 attached to CP 352 does not explain the nature, scope, or type of matters that ASIC may choose to communicate under subparagraph 11(d).

Because we do not wish to speculate on what matters ASIC may choose to report under this broad condition, in the absence of clarity, we are unable to support this element of the proposal.

B1Q2 Are there any additional types of audit quality findings that should be communicated?

None.

B1Q3 Do you have any other comments on the types of audit quality findings proposed to be communicated as set out in paragraph 11?

No further comments.

Should you wish to discuss any aspects of our submission, please contact the undersigned.

Sincerely

Nexia Australia Pty Ltd

Martin Olde

National Technical Director