

Mr Doug Niven  
Australian and Securities Commission  
Senior Executive Leader  
Financial Reporting and Audit  
GPO Box 9827  
Sydney  
NSW 2001

6 October 2016

Dear Mr Niven

**CONSULTATION PAPER 265 - COMMUNICATING AUDIT FINDINGS TO DIRECTORS, AUDIT COMMITTEES OR SENIOR MANAGERS (CP 265)**

**Introduction**

BDO Australia (BDO or we) welcomes the opportunity to provide this submission on CP 265.

The proposed Regulatory Guide (RG) that ASIC intends to finalise once the consultation process has been completed will inevitably have a significant impact on audit practice and procedure as well as on the relationship between audit firms and their clients. BDO is therefore concerned to see that the RG goes no further than is necessary to implement the policy objectives of the amendments to section 127 ASIC Act 2001 that were made by the *Corporations Legislation Amendment (Audit Enhancement) Act 2012 (section 127 Amendments)*.

We note that the above Act commenced on 27 June 2012 yet ASIC has not yet acted on the new provisions and has only just released CP 265. There is nothing in any of ASIC's audit inspection reports issued since 2012 or auditor behaviour that would suggest a reason why ASIC now needs to implement the section 127 Amendments. CP 265 sheds no light on this. It would assist BDO and the wider auditing community if ASIC indicated why it has chosen to act now, as that may better inform any further consultation ASIC has about CP 265 with BDO and the wider auditing community.

We accept that auditors are 'gatekeepers' of the financial markets and have a responsibility to ensure that financial reports comply with accounting standards and provided useful information, but directors and officers are no less so. BDO considers that there ought to be an increased focus on directors and officers to ensure that they are resourcing the entity and providing appropriate governance to ensure that the information provided to auditors is fit for purpose and adequate to meet their financial reporting obligations. BDO is also concerned that what is proposed in CP 265 blurs the lines between the regulatory function and the auditor and client relationship.

We do not require our submission to be kept confidential.

## Responses to the Questions in CP 265

We provide the following responses to the questions posed in CP 265:

*B1Q1: Do you have any comments on our proposed criteria set out in Table 1?*

*B1Q1: Are there any additional criteria that we should consider including?*

BDO is generally supportive of direct communication between ASIC and those charged with governance.

We are however concerned by the way the Criteria set out in Table 1 are expressed and the lack of process on how any communication would occur.

Criteria 1 to 5 in many respects lack specificity. Expressions such as “We have concerns...” (from Criteria 1), “particularly significant findings” (from the Note to Criteria 2) are too general for us to know what ASIC has in mind in the particular instance. We believe that ASIC must better define issues raised in inspections so that there is clarity for both the auditor and ASIC on the severity of an issue. Without this clarity it will be difficult to get agreement with the auditor on an issue and accordingly communicate with our client in a manner we support. It is by no means clear what ‘real life’ examples ASIC has in mind as warranting action under any one of the criteria. The four examples provided on page 50 of the Explanatory Memorandum to the *Corporations Legislation Amendment (Audit Enhancement) Bill 2012* provide some insights but they too are expressed in general terms.

We are also concerned that ASIC has not set out the process for agreeing issues with the auditor that it is considering be communicated to directors nor addressed how differences in opinions on significant issues will be managed.

Under cover of the above observations, BDO’s position on the Criteria is as follows:

1. We support Criteria 1 where there is agreement that the financial report is materially misstated;
2. We support Criteria 2 provided that the auditor accepts that ASIC is correct and has agreed to take additional action;
3. We do not support Criteria 3;
4. We support Criteria 4;
5. We support Criteria 5 on the basis that the matters set out in (a) to (e) are adequately considered by ASIC and areas of genuine disagreement or uncertainty are not communicated.

There are no other criteria that BDO considers ASIC should consider.

In relation to the observations made in support of ASIC’s proposal at B1, we say:

1. Paragraph 14: the reference to the basis of measuring audit quality used by ASIC and adopted by the International Forum of Independent Audit Regulators and other international audit regulators indicates the current adhoc measurement system will continue. We believe there needs to be a better system adopted that defines issues raised in inspections so that there is clarity for both the auditor and ASIC on the severity of an issue.
2. Paragraph 19: it is unclear to us why ASIC needs to resort to what might be on an audit file to resolve “a concern” about an entity’s financial report. ASIC has been able to do this successfully

through its financial reporting surveillance program without availing itself of the powers granted by the section 127 Amendments.

3. Paragraph 20: if ASIC determines, at some stage, that it should communicate findings from its reviews of audit files to other regulators, we consider that ASIC should publish a consultation paper to seek the views of interested parties before doing so. Such communications may have unintended adverse consequences on the affected parties.

*B2Q1 Do you agree that we should let directors know that we will be reviewing audit files relating to the entity as part of a routine audit firm inspection?*

*B2Q2 Should we also let directors of an audited entity know that we will be reviewing audit files relating to the entity as part of a surveillance activity where we already have reason for concern about the adequacy of the audit?*

BDO does not consider that routine audit file inspections should be ‘flagged’ to directors at the time of selection. Given that the file review has not yet occurred there is a risk that directors will be concerned this may be suggestive of problems, issues or errors with a particular audit before ASIC have completed work and any findings are noted.

BDO holds a similar position on B2Q2 principally because of the criteria used - “reason for concern” - which provides no guidance as to ASIC’s decision making process or whether the auditor has been given an opportunity to be heard and respond to any concerns (although it appears that ASIC is not contemplating giving the auditor the seven days’ notice referred to in section 127(2F) ASIC Act).

#### **General Observations**

BDO considers that the implementation of the proposals in CP 265 will have an impact on the duties of directors under the *Corporations Act 2001* and the common law generally and for listed entities, their obligations with respect to the continuous disclosure regime. This in turn will have an impact on investors and potentially an entity’s share price. These matters need to be carefully considered before CP 265 is implemented.

BDO would welcome the opportunity to meet with you either personally or as part of a round table discussion with other audit firms to discuss this submission.

Yours faithfully  
**BDO Australia Ltd**



Tim Kendall  
National Audit Leader