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Dear Doug

**Consultation Paper 265 *Communicating audit findings to directors, audit committees or senior managers (CP 265)***

CPA Australia welcomes the opportunity to respond to CP 265. CPA Australia represents the diverse interests of more than 155,000 members in 118 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

CPA Australia acknowledges that ASIC has the statutory power to communicate specific financial reporting and audit findings identified from its auditor inspections and auditor surveillance directly to directors, audit committees or senior managers of companies, responsible entities or disclosing entities. We support ASIC's intention to identify the criteria that form the basis for determining which audit findings to communicate. We understand that the criteria identified as a result of CP 265 will be reflected in a new Regulatory Guide (RG). However, we consider that the criteria will firstly need to be more clearly articulated and relevant thresholds set, which would trigger direct communication with the entity.

We consider that the RG should be focussed on audit inspection and surveillance findings (audit findings) and not confused with financial reporting surveillance findings. In addition, to the criteria for communication, we recommend that the process to be applied in communicating findings should be set out in the proposed RG. Communication of audit findings regarding audit deficiencies and financial reporting misstatements require different considerations, so we suggest that two different processes are needed. It may be appropriate to communicate financial reporting misstatements at an earlier stage than audit deficiencies, as the auditor needs to be given the opportunity to respond to such findings where they relate to audit quality.

The proposed RG needs to set out how direct communication with the entity is going to be undertaken alongside ASIC's communication of audit deficiencies to auditors and any report of those deficiencies under the ASIC Act, taking into account the auditors' own communication processes with their client. The process for handling any disagreements regarding audit findings between ASIC and the auditor, and how these will be communicated with the entity, also needs to be outlined. We discuss these matters in more details below.

## Scope of Paper

The scope of the consultation paper is somewhat unclear and the terminology needs to be clarified. We note that ASIC conducts both “auditor inspections”, which are essentially routine inspections, and “auditor surveillance”, which results from a complaint or other intelligence, including matters arising from the financial reporting surveillance program. We note that whilst the title of CP 265 refers to “audit findings” and the stated purpose of the paper relates only to findings from “reviews of audit files” it later includes communicating “specific financial reporting and audit findings” (Proposal B1). Whilst this could be interpreted as referring to financial reporting issues arising from audit findings, the paper later refers to “audit inspections and financial reporting surveillance” (para.16). As these are two distinct programs, ASIC needs to be clear as to which are addressed by the criteria. We suggest that the RG be limited to auditor inspections and auditor surveillance and not cover financial reporting surveillance (except to the extent that it has triggered auditor surveillance). Consistent terminology would also aid clarity, as the terms review, inspection and surveillance are all used in the paper, at times interchangeably.

## Process for communication

It would be helpful if the proposed regulatory guide not only provides the criteria (which we comment on below under the specific questions) ASIC will use to determine if it will disclose auditor inspection or surveillance findings to directors, audit committees or senior managers, but also sets out the process which ASIC will follow to disclose those findings. The ASIC Act (s.50B) allows ASIC to notify the auditor of an audit deficiency. If it does so the notice must set out, amongst other matters, any remedial action which ASIC thinks is necessary to remediate the deficiency. ASIC must then invite the auditor to make a written submission about the deficiency, and any remedial action taken or proposed to be taken, and allow 6 months for the auditor to make that submission. If appropriate remedial action has not been taken by the auditor, ASIC can prepare an *audit deficiency report* (s.50C), but only once that 6 month submission period has elapsed. The audit deficiency report may be published, but must include any comments received from the auditor (s.50E). As the CP only contemplates communication of the most serious audit deficiencies, we would expect that ASIC would communicate the audit deficiency to the auditor first and allow the required six months for them to respond, prior to communicating with the entity as a matter of procedural fairness. However, this is not addressed in the paper. The process for communication with the directors, audit committees or senior managers of an audit deficiency should be clearly linked with the notification to the auditor.

With respect to process, we recommend that the proposed RG addresses:

- For identified audit deficiencies:
  - Whether, a notification of audit deficiency must be issued to the auditor under s.50B of the ASIC Act before ASIC discloses information directly to the entity under s.127(2D) of the ASIC Act and how any notification would interact with the minimum 7 days’ notice which must be provided to the auditor prior to ASIC disclosing the matter to the entity.
  - If disclosure to the entity should occur within the 6 month period which the auditor is given to make a submission to ASIC or if ASIC should wait until the auditor has had a chance to make a submission.
  - Whether ASIC would communicate to the auditor any disclosure it makes about audit deficiencies to the entity, in addition to the required 7 day notice.
- For material misstatements in the financial report or continuous disclosure requirements identified from auditor inspection or surveillance:
  - Whether disclosure of this information directly to the entity should only occur if the auditor has not already notified the entity within a reasonable or specified timeframe.
  - Whether ASIC should notify the auditor before the misstatement is communicated, as the minimum 7 days’ notice is only required for audit deficiencies.
  - Whether ASIC would communicate to the auditor any disclosure it makes about misstatements to the entity.

## Privacy

We suggest that ASIC considers whether there could be any unintended consequences as a result of direct communication of audit findings with the entity. For example, will communication of matters directly to the entity necessitate the directors to release that information to meet continuous disclosure requirements? It may be helpful for ASIC to consider whether any written communication ASIC makes regarding audit deficiencies or financial report misstatements identified as a result of auditor inspections or surveillance creates an obligation on directors to disclose.

## Response to Specific Questions

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

We suggest that the criteria should relate to communicating auditor inspection and surveillance findings only as that is the intended scope of the paper, as explained above. Therefore, we suggest that the title of this table should be amended to read: *Table 1: Proposed criteria for communicating auditor inspection and surveillance findings.*

We consider that the criteria are not clear enough to provide a basis for ASIC's decision to communicate audit findings directly to an entity, which will result in inconsistent application and stakeholder uncertainty regarding when direct communication will occur.

We set out below our views on each criterion.

Criterion 1: Whilst we agree that material misstatements should be resolved if possible, we are concerned about the description of this criterion. The criterion needs to exclude the circumstances where the auditor has already communicated the material misstatement. In addition, we would not consider it to be ASIC's role to share documents from the audit file and so a request for the auditor to share the relevant documents with the entity may be a more appropriate approach. If those documents are from the entity's records, then the entity should already have access to them, although para. 19 of the paper raises circumstances where they may not have been produced. These circumstances could be addressed more explicitly under this criterion.

Criterion 2: We agree with this criterion.

Criterion 3: We disagree with this criterion as we consider that the matter should be captured by either Criterion 2, failure to obtain reasonable assurance, or Criterion 4, failure to meet the independence requirements. If communication directly with the entity takes place prior to enforcement action, this should not undermine due process by suggesting the entity takes action prior to any outcomes of that undertaken by ASIC. The anticipated outcome or time it may take to consider at the CALDB or in the courts cannot be a reason to communicate matters as it could undermine the fairness of the process.

Criterion 4: We agree with this criterion.

Criterion 5: We agree with this criterion but suggest that the description needs to provide clarity regarding the circumstances which would result in ASIC communicating its findings directly with the entity. As currently drafted it essentially remains open to the regulator's discretion and may result in inconsistent outcomes.

The description of this criterion could be amended to read: ASIC will communicate its audit findings if it forms the view that the auditor has not obtained reasonable assurance, has not communicated the matter with the entity to ASIC's satisfaction and:

- a) The entity's financial report has not been restated to address the auditor inspection or surveillance finding; or
- b) It is likely that the financial report is materially misstated; or
- c) The auditor has failed to remediate ASIC's concerns regarding audit deficiencies; or
- d) The auditor has failed to put adequate plans in place to remediate ASIC's concerns.

The final point (e) under the description of this criterion relates to interpretation of auditing or accounting standards, which needs to be addressed separately. It would be helpful if the paper could articulate the process ASIC will follow if there is a genuine uncertainty about the audit work required by the auditing or accounting standards. Perhaps an independent review process could be considered.

Paragraph 16 suggests that ASIC auditor inspections will not focus on disclosure issues and will exclude matters within a range of reasonable judgement or genuine issues of interpretation of accounting or auditing standards. We do not consider that this is realistic as ASIC will not always know whether a matter will involve judgement or interpretation of standards prior to reviewing the matter. Furthermore, it is at odds with the statement in Table 1, criteria 5(e), which indicates circumstances where there is an issue of interpretation of accounting or auditing standards. This paragraph also refers to the relevant “international standards-setting body”, however the relevant standards setting bodies are those which issue standards enforceable by ASIC, being the Australian Accounting Standards Board and Auditing and Assurance Standards Board. Therefore we suggest making reference to “Australian standards-setting body”.

**B1Q2 Are there any additional criteria that we should consider including?**

The criteria need to reflect that:

- Only significant audit deficiencies or material misstatements in the financial report are communicated directly with the entity.
- Direct communication only takes place if the auditor has not satisfactorily communicated the matter to the entity already.

Paragraph 18 states that matters may be communicated with the co-operation of the auditor or through ASIC’s power to communicate, presumably without the co-operation of the auditor. This does not specify whether co-operation of the auditor would always be sought prior to communication with the entity and when communication would go ahead without such co-operation.

**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?**

CPA Australia is supportive of ASIC advising the directors that it will be reviewing the audit file of the entity as part of a routine inspection.

It would be helpful if the process is better articulated, so that it is clear if and when this would be done through the auditor.

**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?**

We are also supportive of ASIC advising the directors that it will be including the audit file of the entity as part of an inspection initiated for any other reason. However, we query the need to differentiate routine audit inspections from audit surveillance, which has been initiated as a result of information or intelligence received, when communicating that the client’s file is included, as this may prejudice the auditor when a finding has not yet been reached. The reason for the audit being selected is not relevant and may reflect poorly on the auditor prior to any inadequacy being identified by ASIC. Therefore, we support communication of the fact that the audit file of the entity is to be included in an auditor inspection or surveillance without identification of the reason that the auditor or audit has been selected.

**Regulatory and financial impact**

Disclosure of audit deficiencies or material misstatements directly to the entity may have cost implications. However, the costs are difficult to quantify as they depend on the frequency of disclosures by ASIC in this way and whether any difference of opinion exists between ASIC and the auditor on the appropriate remediation.

If you require further information on our views expressed in this submission please contact Claire Grayston on (03) 9606 5183 or at [claire.grayston@cpaaustralia.com.au](mailto:claire.grayston@cpaaustralia.com.au).

Yours sincerely

A handwritten signature in black ink, appearing to be 'Stuart Dignam', with a long horizontal stroke extending to the right.

Stuart Dignam  
General Manager, Policy & Corporate Affairs