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B POWERS

Ref: KLB/TN

07 October 2016

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

Dear Doug,

SUBMISSION – COMMUNICATING AUDIT FINDINGS TO DIRECTORS, AUDIT COMMITTEES OR SENIOR MANAGERS (CONSULTATION PAPER 265)

We appreciate the opportunity to provide comment to the Australian Securities and Investments Commission (ASIC) on Consultation Paper 265 *Communicating audit findings to directors, audit committees or senior managers*.

Pitcher Partners is an association of independent firms operating from all major cities in Australia. Firms in the Pitcher Partners network are full service firms and we are committed to high ethical standards across all areas of our practice. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities, and small to medium sized enterprises.

We support the ASIC's efforts to facilitate greater communication of the regulatory process including surveillance programs, to enhance the quality of financial reporting and the findings of quality reviews. Nevertheless, in its current form we believe that the consultation paper has fundamental flaws which would not be addressed through subsequent publication of a regulatory guide.

Our detailed responses to the questions contained in consultation paper 265 are attached to this letter. In its current form we do not believe the paper has sufficient clarity on the criteria, procedures and communications to be issued, but would welcome the opportunity to engage in any further discussion of this topic with other interested parties.

Please contact either myself or Tim Nesbitt, Director - Audit & Accounting Technical (03 8612 9596 or tim.nesbitt@pitcher.com.au), in relation to any of the matters outlined in this submission.

Yours sincerely,

K L Byrne
Partner

T Nesbitt
Director, Audit & Accounting Technical

Consultation Paper 265: Communicating audit findings to directors, audit committees or senior managers

Specific matters for comment:

Proposal 1

B1 a) communicate our specific financial reporting and audit findings to directors, audit committees or senior managers of companies, responsible entities or disclosing entities, having regard to the criteria set out in Table 1 of the consultation paper.

Feedback

Do you have any comments on our proposal criteria set out in Table 1?

Response:

Criteria 1 – Communication of material misstatement will assist in timely resolution of the matter – unsure from the criteria description how this would work in effect. The working papers should not be viewed in isolation as the audit report is formed on the financial statements as a whole. Further the working papers should not be released to third parties and remain property of the auditor.

Criteria 2 – Finding from a previous year has not been addressed. – The lack of clarity on when this will occur makes evaluation difficult. Is the current comment form reporting an indication of when this would be effective? If so areas of judgement and arbitration of views between ASIC and the auditor are not catered for in this criteria. Perhaps the proposed regulatory guide can provide additional clarity.

Criteria 3 – Planned enforcement action – There is no procedure here for determining when the matter will not be taken to the CALDB or the courts and as such this lacks clarity and procedural fairness in its current form.

Criteria 4 – Independence requirements not met – no comments

Criteria 5 – Failure to obtain reasonable assurance that a financial report is free of material misstatement across a number of key areas – The criteria is subjective, who decides the outcome? Is there consultation on the decision, is there a right of reply. Many of the areas of ASIC findings are judgemental and so if they are not fact based communicating things to the client is not necessarily going to enhance audit quality or the confidence in the market.

Proposal 2

B1 b) release a regulatory guide setting out these criteria and explaining how they will apply.

Feedback requested

Are there any additional criteria that we should consider including?

Response:

The paper does not provide sufficient detail on the criteria or how they will function in substance to provide a final conclusion. We would however, welcome the opportunity to discuss further the concepts with relevant parties.

Proposal 3
B2) we propose to let an entity's board of directors know that we will be reviewing audit files relating to the entity as part of our routine audit firm inspections.
Feedback requested - A 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?
Feedback requested - B 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?

Response A:

Informing Directors and those charged with governance that their audit is subject to ASIC review is something which Pitcher Partners is already doing. As such we do not foresee any additional costs in ASIC informing the client, however, we do feel that if ASIC wants to formally notify clients rather than making it the responsibility of the auditor it would be preferable for ASIC to inform the auditor prior to informing the client and that we have sufficient time to inform the client prior to ASIC notifying the client of the review.

Further that the communication is clear that the review is part of the normal inspection program and that there is no suggestion that the file has been selected on any specific basis or question of inadequacy either at the file or the firm level. The paper contains a number of areas where we believe further clarity is required before a final conclusion can be rendered. We would however, welcome the opportunity to discuss further the concepts with relevant parties.

Response B:

The public identification of individual clients would not seem to have any benefits and in fact would have some substantial costs to the businesses, involved and potentially the audit team as well. Further it would seem to run contrary to the premise of "innocent until proven guilty". The additional disclosures may also drive auditors from the profession where they feel they may be "accused" publically through the announcement of the investigation without any actual proof being obtained at the point of "accusation". Further there is no clarity on what the obligations of a Director would be in this circumstance such as exercising their right to remove the auditor and or under continuous disclosure requirements to make the ASIC notification public. This would likely reduce confidence in the capital markets and in the profession as a whole. Further if Directors felt the need to disclose due to the continuous disclosure requirements then potentially businesses may find it substantially more challenging to continue as a going concern or to do business following the disclosure.

Similarly the impact of making surveillance activities public, on audit practices may be acute in terms of ability to retain or win new work while the matter is open even though they have yet to conclude themselves on the matter.

Further understanding what these surveillance activities are that could indicate an audit is not being appropriately conducted ahead of time would make it easier to fully evaluate this proposal. We would however, welcome the opportunity to discuss further the concepts with relevant parties.

Other comments

Further to the comments above, we have included specific comments on the individual paragraphs of the paper or interest or concern to us as an appendix to this letter.

Appendix

In responding to the questions raised in the ASIC consultation paper specifically we also include comments on specific paragraphs within the paper which are of interest to us.

<i>Paragraph</i>	<i>Comment</i>
2	<p>While acknowledging the auditor will be given 7 days notice prior to the communication of the information it is unclear from the paper:</p> <ul style="list-style-type: none"> • Exactly what and how the information will be communicated and obtained, in particular references to audit working papers these remain the property of the audit firm and could be substantially misleading if presented as extracts or in isolation of the entire audit file which represents the body of evidence supporting the opinion on the financial statements as a whole. • What process will be entered into to discuss the information with the auditor. • Whether areas of judgement or differences of opinion will be presented in the communications with the auditor. • How will an area of disagreement on a matter of judgement be arbitrated? And determined to be communicated, the details of para 18 would indicate that it can be done entirely without the auditor. The lack of procedure and arbitration and discussion of what will be communicated is unclear and inherently inappropriate.
3	<p>The continuous disclosure requirements mentioned in paragraph 3 b (ii) raise an important consideration which is not discussed in the paper about the requirements for the Directors of the entity to disclose ASIC raising issues, and whether this means they have failed in their fiduciary duties. The legal ramifications are not considered in the paper, nor are the costs of obtaining advice by both the directors and potentially the auditor.</p>
5	<p>At Pitcher Partners we as a matter of policy disclose to our clients when they are selected for ASIC review. This would appear to be the most appropriate method of communication with the client</p>
6	<p>Without the accompanying regulatory guide we cannot provide final or detailed commentary on the appropriateness of the criteria proposed in the paper.</p>
8	<p>This is already part of our policy and as such we see no reason for ASIC to notify the client in addition. Further it is unclear whether the notification will be before or after notifying the auditor.</p>
9	<p>Refer previous comments on paragraph 6.</p>
12	<p>RG26 already provides the capacity for resignation of an auditor. We have concerns about the basis on which the directors would be making this decision as the criteria in table 1 are unclear on the source and provision of information to the directors, further while not specific to the auditor, what are the potential legal consequences of ASIC advice of this nature for the directors in this instance?</p>
14	<p>What is the reference within the auditing standards providing a framework for the criteria?</p>
15	<p>The framework in table 1 is vague in both the specific criteria and its guidance as to what constitutes a reportable matter. There is no guidance on what would actually be communicated, whether areas of disagreement would be</p>

<i>Paragraph</i>	<i>Comment</i>
	presented and who would arbitrate if anyone on an area of disagreement between those matters ASIC seeks to report and what the auditor believes. (refer also para 16)
16	(b & c) what constitutes an area of genuine issue? Currently there are areas where ASIC has a different view to the audit team and these matters are included in comment letters, there is no guidance here on what would constitute a genuine issue and who would determine this fact, and whether the alternative views would be presented. Also with reference to point c) should this not be the AUASB rather than an international body?
18	Clarity on whether the auditor will or will not be involved. This appears to read as though ASIC will be the sole determinant of whether to communicate and whether they will use the auditor or not.
19	a) This implies that reviews will be real time on live files rather than post signing? Is this a change in policy? c) We are unclear how ASIC would obtain information about an overseas subsidiary which the Directors did not have.
22	This implies that the Directors will know both that the review has occurred and will have the findings. Refer also previous comments about communicating excerpts of audit files and obligations of the directors in this scenario.
23	We do not believe that the paper as it stands provides clarity on the process, information to be communicated, the timing, involvement of the auditor or evaluation and arbitration of items to be included in any communication, or the time and effort involved in any communication with a regulator for a client. Further the disclosure of surveillance programs and report findings to clients may in our opinion reduce the confidence in the markets.