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Doug Niven
Chief Accountant
Australian Securities and Investments Commission
GPO Box 9827
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11 February 2022

Dear Doug

Consultation paper 352: Communicating audit findings to directors, audit committees or senior managers

As a leading professional services firm, KPMG Australia (KPMG) is committed to meeting the requirements of all our stakeholders – not only the organisations we audit and advise, but also employees, governments, regulators and the wider community. We welcome the opportunity to provide a submission in response to ASIC's Consultation Paper 352 *Communicating audit findings to directors, audit committees or senior managers* (the consultation paper).

KPMG's Commitment to Audit Quality and Transparency

KPMG's 2021 Transparency Report¹ focuses on how KPMG drives audit quality, our systems of quality control, and the initiatives we are continuously pursuing to improve it. We see audit quality as fundamental to maintaining public trust in the capital markets and the financial reports issued by audited organisations. We aim to lead the profession in audit quality. Quality is fundamental to our purpose, and we constantly monitor and evaluate it. Importantly, we recognise that greater transparency is needed for the public to gain insight into audit services and welcome the proposals outlined in the consultation paper.

KPMG takes findings from ASIC's inspection process seriously and considers that the process provides valuable insights to improve the quality of our audits and increase transparency. KPMG routinely shares the results of ASIC audit inspection findings with relevant clients and notifies clients when their audits are selected for inspection. We also develop a plan for remedial action where appropriate.

KPMG understands that ASIC is seeking feedback on the proposal to communicate findings from the reviews of audit files to directors of the entities audited on a routine, as opposed to currently, an exception basis. This proposal would inform the revision of

¹ [KPMG's Transparency Report 2021 - KPMG Australia \(home.kpmg\)](#)

the regulatory guide *Communicating findings from audit files to directors, audit committees or senior managers (RG 260)*.

KPMG supports, in principle, ASIC's proposal to communicate findings on a routine basis, which should help to provide further transparency around ASIC's inspection process and resulting findings.

However, KPMG believes the following matters warrant further consideration to ensure the proposed new communication process is effective, transparent and fair.

Summary of KPMG's recommendations:

- **Language use:** It is important that ASIC findings, together with the firm's full final response are communicated together, and written in a manner that is readily understandable by stakeholders who are not audit experts. Not all of key stakeholders necessarily have a detailed understanding of the audit process, auditing standards and/or of ASIC's inspection process. This could entail providing appropriate context and explanations, including that findings do not necessarily mean that the financial report is materially misstated, nor the audit opinion inappropriate.
- **Significance of findings:** Audit quality findings should only be communicated where ASIC has formed the view that an auditor has not obtained reasonable assurance that an entity's financial report is free of material misstatement, and not in relation to less significant observations.
- **Improvement in future years:** Communication of circumstances where audit work should be improved in future years may not be necessary where the audit firm demonstrates that it intends to address the particular issue.
- **Other matters:** Communication of "other matters" should be appropriately defined and limited to matters directly related to audit quality, as this prima facie is a very broad concept.
- **Positive findings:** It would also be beneficial to communicate key audit areas reviewed where no audit quality findings arose.
- **Notification period:** We recommend the adoption of a 14-day notification period to ensure that audit firms can develop an appropriate response before the settled comment form is communicated to clients;
- **Appeals process:** We continue to see benefits in establishing an independent appeals process around ASIC's inspection findings, with formal protocols to provide clarity to all parties and enhance procedural fairness.
- **Introduction date:** The effect of the proposed application date is unclear, specifically, whether comment forms issued after 1 July 2022 would be communicated to clients, or rather, comment forms settled after this date. We recommend this be clarified.

Response to ASIC's specific questions

As set out in the consultation paper, ASIC proposes to communicate audit quality findings where:

- (a) ASIC has formed the view that an auditor has not obtained reasonable assurance that an entity's financial report is free of material misstatement;*
- (b) although reasonable assurance was obtained that the financial report for the current year was free of material misstatement, ASIC considers that audit work should be improved in future years;*
- (c) ASIC has 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; or*
- (d) ASIC considers any other matter should be drawn to the attention of the directors or audit committee of the audited entity.*

In principle, we support ASIC's proposal to communicate findings on a routine basis as it should further enhance the transparency of the audit inspection process and resulting findings. In direct response to specific questions asked in your consultation paper, we highlight the following points:

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

In relation to a), KPMG considers that ASIC should communicate audit quality findings only where ASIC has formed the view that an auditor has not obtained reasonable assurance that an entity's financial report is free of material misstatement. This should help focus the reader's attention on any matters deemed significant, and not on peripheral or non-significant matters.

In relation to b), there may be little benefit in communicating such matters where the audit team have already planned to do additional work in future years / in similar scenarios that may arise in the future.

In relation to c) we consider this would be of limited value to directors of companies who are required to make a statement in the directors' report on whether they are satisfied the auditor has met the relevant audit independence obligations imposed by the Corporations Act 2001, and the directors' reasons for being satisfied. Additionally, such historical findings will generally not alter conclusions reached by the directors at the time the initial statement was made in the directors' report.

In relation to d) the communication of "other matters" is very broad and should be defined. In addition, the example set out in proposed revised RG260.29 "*information available to the auditor and to the directors is inconsistent*", may have limited applicability in practice e.g. where the auditor uses different systems compared to the client, or where the auditor uses proprietary information as audit evidence. We suggest the sentence be revised to "*information available to the*

auditor and the directors is inconsistent, and that inconsistency has not been addressed through the audit.”

- 2 (B1Q2) Are there any additional types of audit quality findings that should be communicated?

No.

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

With reference to the following paragraphs of proposed revised RG 260:

[RG 260.48] We will endeavour to give the auditor appropriate opportunities to respond to our findings.

[RG 260.52] Where we decide to communicate matters to entities after considering any concerns raised by the auditor, we will include the auditor’s response on the matter or a summary of that response in our communication to the entity.

Audit firms may not always agree with ASIC’s findings or the severity of a particular finding, which are often finalised iteratively after confirmation of factual findings and other commentary. We believe it would be inappropriate to communicate anything other than the finalised ASIC comment together with the firm’s final written response within the settled comment form to directors, audit committees or senior managers.

It is important that both ASIC’s and the firm’s response be written in a manner that is understandable to company directors, audit committee members and senior managers. These key stakeholders may not necessarily have a detailed knowledge of the requirements of auditing standards, the inspection process and the relevant financial reporting framework. This should include providing appropriate context and explanations. For example, it should be clear to readers that an ASIC finding/comment does not necessarily mean that there is a material error or omission in the company’s financial report, and or that the audit opinion is incorrect. This would help ensure that findings are not misinterpreted, and to ensure appropriate and targeted discussions between the audit firm and its client in addressing any audit quality observations that have been communicated by ASIC.

ASIC understandably skews its sample selection to the more complex and high-risk audits. It clearly warns against the extrapolation of its results in drawing wider conclusions about a firm’s audit quality² in its annual reporting of inspection findings. We consider this to be important context to a reader that should be

² REP 714 KPMG Australia: Audit inspection report – 1 July 2020 to 31 June 2021: “A limited number of audits and audit areas were selected for review on a risk basis, and so caution is needed in generalising from the results to all audits conducted by the firm and all areas of those audits.”

included in the communication of audit quality findings to directors, audit committees or senior managers.

RG 260.20 (b) notes that audit inspections exclude matters that, in ASIC's view, "are within a range of reasonable judgement". This is often a topic for debate between ASIC and audit firms, and can sometimes result in firms disagreeing with ASIC's observations. In our view, additional processes should be put in place to validate this statement, so that any matters on which different auditors could reasonably reach different conclusions are excluded from communications as appropriate.

Section 127(2D and 2F) of the ASIC Act allows the ASIC Chair to communicate specific financial reporting and audit quality findings and is required to provide the auditor concerned with at least seven days' notice before communicating information. We recommend that this notice period be increased to 14 days to ensure that audit firms can develop an appropriate response before the settled comment form is communicated to clients.

In addition, as acknowledged by the OECD³, we see merit in establishing an appeals process with formal protocols to provide further transparency over the inspection process. There is currently no independent appeals process where firms disagree with ASIC observations. While KPMG understands that there is an independent panel that reviews selected comment forms prior to final reporting, firms currently have no visibility of, or input to, this process. We firmly believe the process would benefit from greater transparency and input from the audit firms to ensure procedural fairness.

Finally, RG 260.54 states ASIC will inform directors of instances where there were no audit quality findings to communicate. In our view, this should equally apply such that ASIC inform directors of key audit areas reviewed where no audit quality findings arose.

Additional Observations

Response to regulatory impact statement

KPMG understands that ASIC may be required to prepare a Regulation Impact Statement to further develop, justify and implement this proposal. If so, we would appreciate the opportunity to comment in relation to the likely compliance costs, the impact on competition and any other costs and benefits. Given KPMG already communicates ASIC findings to its clients, we consider initial compliance costs to be negligible.

In relation to competition, we consider the likely impact to be positive, if appropriate context is provided to audit clients (refer to our detailed comments above). It provides companies with additional information by which audit quality may be assessed.

³OECD Regulatory Enforcement and Inspections Toolkit (2018)

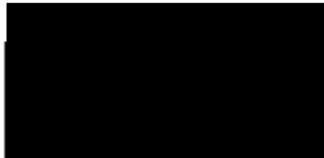


Timing

KPMG understands that the proposed changes would become effective from 1 July 2022. We would appreciate further clarity around whether the application date applies to comment forms issued after this date, or rather comment forms settled after this date.

Thank you for the opportunity to provide comment on this important matter. Should you have any additional questions or would like to discuss the contents of this letter further, please contact me or Bernie Szentirmay [REDACTED].

Yours sincerely,



Julian McPherson
National Partner in Charge, External Audit