

Via email: [auditquality@treasury.gov.au](mailto:auditquality@treasury.gov.au)

The Manager  
Corporate Reporting and Accountability Unit  
Corporations and Capital Markets Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

28 October 2011

Dear Sir/Madam,

**Re: Corporations Legislation Amendment (Audit Enhancement) Bill 2011**

BDO welcomes the opportunity to comment on the Exposure Draft of the Corporations Legislation Amendment (Audit Enhancement) Bill 2011 (the Draft Bill).

Whilst we agree with Treasury's overall conclusion in respect of Australia's audit regulation framework and we appreciate that the consultation process on this paper started before the recent developments in Europe in respect of the House of Lords enquiry and the EU green paper and as such, the paper did not look at the issue of audit quality against a background of significant audit failure in Europe.

BDO has concerns in respect of the medium to long term sustainability of audit quality, and welcomes further consideration of issues of systemic weaknesses in the audit profession and in particular, considering over concentration and the issue of "too big to fail".

We urge Treasury to keep a watching brief on global developments in respect of enhancing audit quality and the sustainability of the audit profession and also to consider the role that an audit committee should play in driving audit quality.

BDO has the following comments for your consideration on the legislative proposals as contained in the Draft Bill.

**Auditor Rotation**

BDO supports the change from 5 to 7 years for listed entities, particularly where complex organisations or specialist industries are concerned, as a deep understanding of such entities by the auditor is more likely to ensure audit quality than the perception that familiarity ultimately compromises audit quality.

The proposal requires that the extension is only allowed if "it is *necessary* to safeguard the quality of the audit". We would recommend that the extension of the rotation period be permitted if it is "*consistent with maintaining the quality of the audit provided and that the audit committee is satisfied suitable safeguards have been put in place to overcome any perceived familiarity risk.*"

We believe that this change in terminology from “necessary to safeguard” to “consistent with maintaining the quality of the audit” allows for greater application.

We also believe it is important to ensure the audit committee properly considers the familiarity risk in extending any rotation periods and therefore suggest adding a reference to the audit committee being satisfied that suitable safeguards are in place to overcome perceived familiarity will ensure this occurs.

BDO has the following observations in respect of the practical drafting of the legislation:

- Section 1 proposes to repeal the subheading before section 300(11) of the Act, “Special rules for listed companies”, and to replace it with a subheading “Special rules for listed companies and schemes”. This may be confusing as section 300(11) relates only to listed companies and not to registered schemes.
- Section 2 proposes to insert immediately after section 300(11) a new section 300(11AA) which relates to listed companies and listed registered schemes. The Act currently contains a section 300(11A), section 300(11B), section 300(11C), section 300(11D) and section 300(11E). All these sections relate to listed companies only.
- The ED is proposing to insert section 300(11AA) immediately after section 300(11). Given that logically section 300(11AA) should follow section 300(11A), and the fact that sections 300(11A) to 300(11E) all relate to listed companies only, we believe that inserting section 300(11AA) in the middle of other sections that only apply to listed companies will be confusing.

We suggest that section 2 should instead be dealt with as follows:

- (a) Leave application of the whole of section 300(11) as applying to listed companies only.
- (b) After section 300(11A), add in a section called section 300(11AA) with a subheading called “Directors extend eligibility term”. Include wording as proposed in section 2 of the ED, except that it should only refer to “listed company” and not to “listed registered scheme”.
- (c) After section 300(12), add in a section 300(12A) with a subheading called “Directors extend eligibility term”. Include wording as proposed in section 2 of the ED, except that it should only refer to “listed registered scheme” and not to “listed company”.

We consider that duplicating the proposed section 300(11AA) requirements in separate sections for listed companies and listed registered schemes will be less confusing for preparers of directors’ reports.

### **Annual Transparency Report**

We support in principle the requirement of a transparency report. We would make the following observations:

- The Report should be in line with the structure of the transparency report required by the European Union
- All efforts should be made to prevent the reports becoming “boiler plate”
- Statements made in the report should be subject to inspection as part of the ASIC inspection process
- Given the geographical distance between major offices, key statistics in respect of number of entities audited, number of audit partners should be made on a geographical (state or office basis), not just in terms of legal entity
- Some flexibility should be given in respect of reporting financial data etc, so as to align to firm’s individual year ends
- Reasons for non disclosure should be scrutinised by ASIC
- All efforts should be made to ensure this report is more than just corporate advertising

### **Auditor Independence Functions**

BDO supports the streamlining of the auditor independence work of ASIC and the Financial Reporting Council (FRC).

### **Auditor Deficiency Notifications and Reports**

BDO supports the individual reporting of audit quality inspections, wishing that this reporting be used constructively to drive audit quality forward. However, we do have concerns that an inappropriate reporting framework may:

- Create unnecessary concerns within the capital markets
- Create undue delays in reporting findings
- Result in time consuming (and costly) disputes between audit firms and the regulator

Based on the above we favour the Canadian reporting model. We also have the following observations:

- A grading system should be introduced for the weaknesses identified by ASIC either by weakness:
  - Significant weakness, resulting in wrong audit opinion
  - Significant weakness, insufficient audit evidence to support the opinion
  - Multiple, technical non compliances with auditing standards
  - Isolated technical non compliance with auditing standards
  - Areas for improvement

- Alternatively findings could be reported by audit file and graded as follows:
  - Good with limited improvements required
  - Acceptable but with improvements required
  - Significant improvements required
- Any deficiency report should clearly grade the deficiencies appropriately and only focus on significant audit weaknesses
- The proposal gives a 6 month time frame to implement required changes. In practical terms, many changes can only be implemented at the time of the next audit cycle which may be outside of the 6 months timeframe
- There should be an appeals process for disputed findings / recommendations with the public report being delayed until the conclusion of the appeals process
- An alternative to an appeals process could be a "right to reply", similar in nature to a management letter, whereby the firm responds as to why they disagree with ASIC's finding or recommendation.

#### **Communication with Corporations, Registered Schemes and Disclosing Entities**

BDO is of the opinion that ASIC currently has adequate powers of disclosure and we have been unable to identify instances or potential situations which may arise which would necessitate ASIC requiring these powers.

We do have concerns that these powers may bypass normal justice, in respect of disciplinary hearings by CALDB or appeals processes.

However, if ASIC is to be given greater power, we believe that the following provisions should be made:

- a) The auditor is notified in advance of ASIC's intention to exercise this power
- b) The auditor is given full details in writing of the issues to be communicated
- c) Where possible the auditor's view on the issues raised be included within ASIC's communication.

Thank you for the opportunity to comment on the Draft Bill. We would be happy to elaborate on any of the above comments.

Yours faithfully

**BDO Audit (NSW-VIC) Pty Ltd**



Wayne Basford

Director