28 October 2011

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

By email: auditquality@treasury.gov.au

Dear Sir / Madam

Exposure Draft - Enhancing Audit Quality

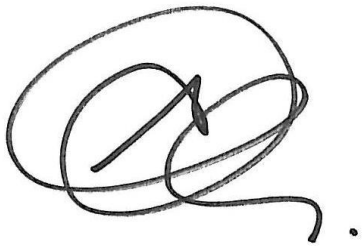
CPA Australia, the Institute of Chartered Accountants in Australia and the Institute of Public Accountants (the Joint Accounting Bodies) are pleased to respond to the Treasury Exposure Draft *Corporations Legislation Amendment (Audit Enhancement) Bill 2011* (the ED).

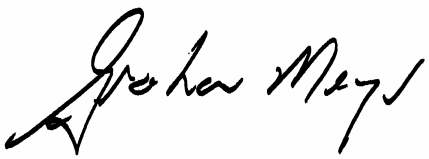
The Joint Accounting Bodies represent over 190,000 professional accountants. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

The Joint Accounting Bodies are committed to supporting developments that enhance audit quality. We commend The Treasury on the extensive approach taken in both its original consultation paper '*Audit Quality in Australia: A Strategic Review*' and the consultation that followed. We are in general support of the ED, subject to some specific refinements and have outlined our comments in the attached appendix.

If you require further information on any of our views, please contact Amir Ghandar, CPA Australia by email amir.ghandar@cpaaustralia.com, Andrew Stringer, the Institute of Chartered Accountants by email andrew.stringer@charteredaccountants.com.au or Tom Ravlic, the Institute of Public Accountants by email tom.ravlic@publicaccountants.org.au.

Yours sincerely





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Appendix

Please find below our comments on the Treasury Exposure Draft *Corporations Legislation Amendment (Audit Enhancement) Bill 2011* (the ED). We have confined our responses to those aspects of the ED on which we have specific comments.

Annual transparency reports

The concept of annual transparency reports is supported. Such reports could contribute to boosting stakeholder understanding of auditors and the quality of audit work. The major accounting firms have in the past issued forms of transparency reports which were lodged with the former Audit Quality Review Board (AQRB). These reports could be used as a precedent for establishing the type of information to be included in the reports being contemplated.

We note two issues that are important to address in implementing this measure:

1. Be mindful that most readers are unlikely to have a background knowledge of the subject matter when the content and form of annual transparency reports is being determined. It must be clear to readers what conclusions can and cannot be drawn from the disclosures by firms to avoid exacerbating the existing gap between expectations and understanding amongst stakeholders and the reality of the audit function.

2. Audit practices of a range of sizes would be captured by the proposed scope for annual transparency reports. Smaller and medium sized practices will have fewer resources to dedicate to the preparation of annual transparency reports. Accordingly consideration should be given to a tiered approach to disclosure based on the number and type of audits undertaken by firms in order not to impose a disproportionate regulatory burden.

Audit deficiency reports

We note that Australian Securities and Investments Commission (ASIC) has existing disciplinary powers over firms and the partners in firms. The purpose of the audit inspection program has been around audit quality improvement and an audit deficiency report in respect of a large firm could be confusing to the market, unless it reflects deficiencies that are so pervasive they would inform users generally.

Therefore while we support the principle of audit deficiency reports, they would need to be used sparingly and with great caution. Such reports should only be contemplated where there is a demonstrable failure to respond to a regulator's request for an audit firm to remediate an identified pervasive issue or issues, within a reasonable timeframe.

The subject of the deficiencies prescribed in the ED[1] involve a high degree of subjectivity in the exercise of judgment. It is crucial that a robust appeal process exists where there is a disagreement between ASIC and the auditor. An audit deficiency report would be expected to have significant negative connotations for the named firm. This impact may be more significant on firms' business in some ways than the principal disciplinary measures currently available (suspension, imposition of conditions on the auditor or removal of auditor registration), which generally apply only to the individual partner.

Given the degree of professional judgement potentially involved in determining what is or is not an audit deficiency, as well as the potential negative impact on a firm of being named in a deficiency report , the appeal process proposed in the ED is not sufficient. As currently proposed it is ASIC alone which needs to be satisfied that appropriate remedial action has, or has not, been taken and consequently whether an audit deficiency report should be issued.

In our view it is vital for there to exist an avenue of appeal to a 'neutral umpire' in these circumstances, prior to publication of audit deficiency reports. This would provide the form of natural justice as it is usually understood by accountants and auditors.

1 "(i) a failure by the auditor to comply with the auditing standards; (ii) a failure by the auditor to comply with the auditor independence requirements in the Corporations Act; (iii) a failure by the auditor to comply with any applicable 21 code of professional conduct; (iv) a failure by the auditor to comply with the provisions of the Corporations Act dealing with the conduct of audits."

Existing bodies such as the Financial Reporting Panel (FRP) or Administrative Appeals Tribunal (AAT) may well be suitable for such a role - the FRP is already being an independent arbitrator between a regulated entity and ASIC, while the AAT has the power to review administrative decisions. We recognise some reshaping would be needed to take on an additional role such as this.

Communications with corporations, registered schemes and disclosing entities

We continue to advocate caution in granting additional powers to ASIC to communicate directly with an audited body in relation to significant matters it identifies during the course of the exercise of its statutory powers in relation to an audit. We note the examples cited in the explanatory memorandum in support of the granting of this additional power.

In particular the interplay between audit deficiency reports and ASIC communicating directly to an audited body is not clear to us.

However, we continue to question the need for this additional power and note that a preferable option would be for ASIC to have the power to compel the auditor to convey this information to the audited body. Only in the event that this is not done should ASIC then be in a position to communicate directly with the audited body. A model similar to this is in place in the United Kingdom, whereby the Financial Reporting Council, in such circumstances, will follow up on what the firm communicates to their client.

Should ASIC be granted the right to communicate directly with the audited body as proposed, and this is consistent with the thinking about when it is appropriate to issue an audit deficiency report, at very least ASIC should be required to communicate this same information to the auditor prior to, or at the same time it is communicated to the audited body.

Auditor rotation requirements

We support the principle of seven year audit partner rotation. However it is not clear if the intention is for the proposed discretion being granted to the board of an audited body is to be exercised only in exceptional circumstances. It would assist audit committees, and boards, if some guidance was provided as to whether this should be used liberally or only in certain limited circumstances.

1. As currently drafted, the extension of the eligibility term for an individual to play a significant role in the audit must be accomplished prior to the end of the five successive financial years which are currently permitted under the *Corporations Act*. It appears that the decision must be taken at that point to extend the period for either one or two additional years.

   However, it is not clear what the situation would be in the event the directors make a decision to extend the period for one additional year, and then prior to the completion of that additional year make the decision that it is necessary to extend the period by a further year (making seven in total).

2. Further, there is an inconsistency between the Explanatory Memorandum and the wording of the draft legislation. The Explanatory Memorandum (paragraph 1.5) states that "The directors are not required to grant approval merely because the audit committee has recommended that an approval be granted". However the draft legislation (324DAB) states:

   (1) If a listed company, or the responsible entity of a listed registered scheme, has an audit committee:

   (a) an approval under section 324DAA must not be granted unless it is in accordance with a recommendation provided by the audit committee; and

   Consequently it is not clear what the directors are able to do if they disagree with the recommendation of the audit committee and do not wish to extend the period at all, or wish to extend the period by one year if the audit committee has recommended two years.