



Law Council OF AUSTRALIA

The Manager
Corporate Reporting and Accountability Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescnt
Parkes AT 26000
Via email: auditquality@treasury.gov.au

Dear Sir/Madam,

Enhancing Audit Quality

1. Introduction.

The Corporations Committee of the Business Law Section of the Law Council of Australia (the **Committee**) is pleased to have the opportunity to provide comments on the Exposure Draft of the Corporations Legislation Amendment (Audit Enhancement) Bill 2011 (the **ED**) and the draft Explanatory Material for the ED (the **EM**).

This submission is concerned solely with the proposed provisions regarding **audit deficiency reports** in Part 2 of Schedule 2 to the ED.

The Committee's submission deals with three main issues:

- The need to ensure an audit client is not identified in an audit deficiency report.
- The need for auditors to be afforded procedural fairness.
- The Committee's concern that these proposals should not be regarded as a precedent for ASIC to be given the power to publically censure market participants in any other context.

2. Identification of audit clients.

The Committee is very strongly of the view that ASIC should not identify an audit client in an audit deficiency report. An audit client would have no opportunity to make submissions to ASIC in relation to the content of the report, but could be materially prejudiced if third parties became aware that ASIC had expressed the view audit deficiencies existed in relation to its financial reports.

In these circumstances, the Committee is pleased to note that paragraph 50D(2)(c) of the ED provides an audit deficiency report published on ASIC's website "must not disclose identifying particulars of the audited body".

However, given the importance of this issue, the Committee does not consider this protection goes far enough. The Committee is of the view that an audit deficiency report should not disclose identifying particulars of the audit client whether or not the report is published on ASIC's website. Accordingly, we consider the restriction in paragraph 50D(2)(c) should also apply to section 50C.

3. Procedural fairness for auditors.

The Committee is concerned that the proposed regime does not afford procedural fairness to auditors. The Committee's principal concerns are:

- The draft legislation does not provide an auditor with an opportunity to review the contents of a draft audit deficiency report (including any amendments to the draft report) or to be given a reasonable opportunity to comment on the report before it is finalised. The Committee does not consider paragraph 50B(2)(b) or sub-section 50C(3) provide adequate protection in this regard.
- If an auditor wishes to do so, it should be given the opportunity to submit comments on an audit deficiency report which must be published as part of the report.
- There should be a review process if an auditor disagrees with ASIC's assessment that there has been an audit deficiency or that the auditor has failed to take any proposed remedial action. In this regard, the Committee is concerned that the comments in paragraph 4.26 of the EM do not provide a balanced assessment of this issue.
- It should be made clear that the views expressed by ASIC in an audit deficiency report do not amount to conclusive findings of fact or determinations of law. It should also be made clear that an audit deficiency report would not have any evidentiary value in any other legal or administrative proceedings.

The Committee notes that the Canadian and US regimes referred to in the EM both provide substantially all of these protection – giving the auditor an opportunity to review draft reports, provide comments that must published and seek a review of decisions made by the regulator.¹

The Committee considers the Australian regime should incorporate these same protections.

4. Appropriateness of “public reprimands” as a regulatory tool.

Subject to the safeguards outlined above, the Committee does not oppose the introduction of regime under which ASIC may publish audit deficiency reports on its website. However, the Committee would be concerned if this regime were to be considered as a precedent for ASIC to be given the power to issue “public reprimands” in other contexts. As a branch of the executive government, ASIC cannot determine criminal guilt or liability for civil or administrative penalties. That is for the courts in the case of criminal offences and civil contraventions, and for the operation of the law itself in the case of true administrative penalties. Any public statements by ASIC should normally reflect the fact that its opinion on any particular breach, or the application of the law generally, remains simply that until vindicated by a court.²

The Committee considers the principles ASIC has adopted in Regulatory Guide 47 in relation to its public statements regarding investigation are sound and believes it would be inappropriate to depart from those principles other than in exceptional circumstances. Accordingly, “public reprimands” should not be considered a routine part of ASIC’s regulatory “toolkit”.

If you have any questions in regard to this submission, please contact the Committee Chair, Guy Alexander on (02) 9230 4874 or Michael Hoyle on (03) 9635 9148.

Yours sincerely,



Tony O'Malley

Section Chairman

¹ See section 400 of the CPAB Rules, section 4 of the PCAOB Rules and section 104(h) of the Sarbanes-Oxley Act of 2002. The UK regime is somewhat different given the high level nature of the public reports published by the Audit Inspection Unit of the Professional Oversight Board on the inspection of individual audit firms.

² See Australian Law Reform Commission Report 95 “Principled Regulation, Federal Civil & Administrative Penalties in Australia”, at [16.121] and ASIC Regulatory Guide 47 “Public Comment”.