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

27 October 2011

Dear Sir / Madam

We are pleased to respond to the Exposure Draft of the Corporations Legislation Amendment (Audit Enhancement) Bill 2011 ("draft proposals").

We support Treasury's overall objectives to improve audit quality and commend your collaborative approach with stakeholders. We encourage Treasury to continue this approach of seeking to understand the practical implications of implementing any measures proposed. Our response to the draft proposals is summarised below.

We have included our detailed drafting comments in Appendix 1. These suggestions focus on procedural matters where we believe the draft legislation may have unintended consequences or may not achieve the objectives set out by Treasury.

Auditor rotation requirements

We support Treasury's objective of introducing some flexibility to extend the five year mandatory partner rotation period.

Annual transparency reports

We support the proposal for audit firms to publish transparency reports and are pleased that Treasury intends that the proposed regulations would be consistent with global guidelines, in particular EU's Statutory Audit Directive (Article 40).

We encourage collaboration in developing these proposed regulations; in particular, so that mutual objectives (sharing meaningful and unprejudicial information that can be obtained without undue cost or effort) can be best met.

Auditor independence function (Role of FRC)

It is now more than 10 years since the FRC was established. Its role has evolved over time and it is appropriate to make the amendments proposed to reflect this. However, we consider that now would be an appropriate time to consider in a more fulsome way the FRC's mandate and what its role and composition might be in the future. We would welcome an opportunity to participate in a dialogue on these aspects.

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Audit or deficiency notifications and reports

We support the extensions proposed to ASIC's powers to issue public reports about its findings on audit quality. We have some concerns regarding the practical implications of the proposed draft legislation and consider that the legislation should include additional measures to ensure that audit firms have adequate opportunity to challenge the information proposed to be disclosed.

Communications with corporations, registered schemes and disclosing entities

We support the objective that ASIC should be able to inform the audit committee or company of significant matters that ASIC becomes aware of during its statutory duties. We recommend that the information provided by ASIC also includes the auditor's perspective on the matters raised.

We would welcome the opportunity to discuss our views at your convenience. Please contact me on (03) 8603 3868 or Valerie Clifford on (03) 8603 3285 if you would like to discuss this further.

Yours sincerely

Jan McCahey
Partner

Appendix 1– Detailed drafting comments

Auditor rotation requirements

- Under section 324DAB, an audit committee or the directors of a company must be satisfied that approval of an extension to the eligibility term is "*necessary* to safeguard the quality of the audit provided to the company or scheme...". This is a very high threshold which may cause the provision to be unworkable in practice. We propose the word "important", or a similar term, may be a more workable alternative which would assist in the practical application of the test.

- It is proposed that approval of an extension to the eligibility term would be ineffective unless sections 324DAA, 324DAB and 324DAC are all complied with (s 324DAD). Some of those steps will not be in the control of the auditor but the auditor commits an offence if all of the steps are not complied with. We recommend that the directors of the company be required to notify the auditor that all the necessary steps have been taken and that the auditor be entitled to rely on the notification for the purpose of satisfying the eligibility requirements.

Annual transparency reports

- We suggest that the timing of publication for a transparency report should take into account the fact that audit firms have different year ends and there needs to be an appropriate amount of time for firms to collect information and produce accounts as is the case for corporations.

- Material may be omitted from a report if it is "likely to result in *unreasonable prejudice*" to the reporting auditor (s332B(2)). As this term is open to a number of possible interpretations we recommend the law include additional guidance. For example, "as determined by the audit firm in its reasonable opinion".

- In relation to proposed section 332C(3), there is no time limit for ASIC to decide whether to make an order extending the 4 month period for publishing a report (s332C(4)). This does not ensure appropriate certainty for an auditor who has sought an extension. We recommend that a time period be inserted.

- Under s332C(4), ASIC is required to give the auditor notice of the making of an order to extend the publication period or an order for exemption from requirements relating to an annual transparency report (s332D). ASIC is not required to give notice of a decision not to make such an order. We recommend that ASIC's obligations be further clarified.

- In relation to the proposed Part 2M.4A, each member of an audit firm would be liable for a contravention unless they did not know of the circumstances constituting the contravention or if they did, they took all reasonable steps to correct it (s332F(4)). The proposed s332F does not provide guidance as to what would constitute reasonable measures and unlike the current auditor independence rules, it does not provide a defence of reasonable belief that the firm had a quality control system in place capable of identifying the contravention (s324CB(6)). We recommend that consideration be given to providing for such a defence to reflect the breadth of practice and the size of membership of audit firms likely to be affected by these proposals.

Audit deficiency notifications and reports

- Under proposed section 50B, ASIC "*may,* in writing, notify the auditor of the identified audit deficiency". Given the potential implications flowing from the identification of audit deficiencies we believe the legislation should provide that ASIC *must* notify the auditor of an identified audit deficiency if it intends to take actions that could lead to the preparation of an audit deficiency report.

- The definition of "identified audit deficiency" is expressed to be a *failure* by the auditor to comply with various requirements. This wording is quite strong and conclusive and does not make it clear that the failure is in the opinion of ASIC, and not the finding of any court or other tribunal. Because of the potential for a notice or report of identified audit deficiency to damage an audit firm we believe that the terminology used in s50A(b) should make it clear that the "failure" is in the opinion of ASIC in each case.

- In relation to proposed section 50C(1), ASIC *may o*nly publish an audit deficiency report after the expiry of the 6 month period in which an auditor has to respond to a notice from ASIC of an identified audit deficiency. We recommend that the words "notified under s50B" be added to the end of the proposed s50C(1) to clarify that ASIC cannot prepare an audit deficiency report unless it has given an auditor notice regarding the relevant identified audit deficiency.

- Under proposed section 50C(3), it is proposed that ASIC would be required to take an auditor's submissions into account before preparing an audit deficiency report. We recommend that ASIC be required to include the auditor's submissions in the audit deficiency report (s50C(2)) if requested by the auditor, to ensure that the auditor's submissions are able to be articulated in the context of ASIC's findings.

- Under section 50D(3), it is proposed that ASIC would give an audit deficiency report to the auditor 7 days prior to publication without an opportunity for the auditor to make submissions in respect of the report. Treasury's proposed objective is to give the auditor 7 days to comment on the report. We recommend that the legislation clarify that ASIC be required to invite the auditor to make written submissions to ASIC in respect of the audit deficiency report and to require ASIC to take into account any such submissions before publishing the report. We also recommend that ASIC be required to publish the auditor's submissions as part of the report if requested by the auditor and that additional time be allowed for this process.

- Treasury has not made any provision for a review by the Administrative Appeals Tribunal (AAT) of ASIC's decision whether to publish an audit deficiency report. Treasury has expressed its concern that the delay caused by an AAT review may defeat the purpose of the audit deficiency report. However, an audit deficiency report has the potential to cause significant reputational damage to an auditor. We believe that auditors be afforded the opportunity to challenge ASIC's decision to publish such a report and not simply to make submissions in respect of its contents.

- A published audit deficiency report would not contain identifying details of any "professional member of the audit team" involved in the audit. As the audit team may be supported by many other parts of the firm, for example development and training experts and the firm's leadership team, we recommend this definition be broadened to restrict the publishing of personal details of any member of the firm.

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Communications with corporations, registered schemes and disclosing entities

- To provide greater safeguards for the auditor, ASIC and the company under this provision, we recommend that ASIC be required to:

  - notify the auditor before providing the information to the client, to give the auditor an opportunity to respond to the information to be provided to the audit committee or company, within a specified period of time, 14 days**;**

  - take into account any response made by the auditor to ASIC when disclosing information to the audit committee or company; and

  - include the auditor's response to ASIC when it decides to disclose the information to the audit committee or company, if requested by the auditor.

  We appreciate this information is often time critical. However, we believe the benefit of having the auditor's perspective from the outset for both ASIC and the company outweighs the disadvantage of the possible delay.