

Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into the regulation of auditing in Australia

Questions on Notice 017

Corporations Act 2001, Volume 2, Chapter 2M, Part 2M.3, Division 3—Audit and auditor's report

1. Who is liable for criminal offences under Division 3? Is it limited to the individual auditor(s)? What liability does a company have? What liability do other partners in a partnership have?
2. Who is liable for any civil action taken as a result of offences under Division 3? Is it limited to the individual auditor(s)? What liability does a company have? What liability do other partners in a partnership have?

Corporations Act 2001 Section 307A: Audit to be conducted in accordance with auditing standards

1. If an auditor does not obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error:
 - a. Is the audit in accord with the auditing standards; and
 - b. Does this, *prima facie*, constitute a breach of Section 307A?
2. When ASIC reaches the view that an auditor did not obtain reasonable assurance:
 - a. What enforcement action does ASIC take?
 - b. Does ASIC inform the audited entity?
3. Does ASIC have 'practice notes' to guide its response when it reaches the view that an auditor did not obtain reasonable assurance?
4. In how many cases where ASIC formed the view that an auditor did not obtain reasonable assurance did ASIC refer the matter to the Companies Auditors Disciplinary Board?
5. In how many cases where ASIC formed the view that an auditor did not obtain reasonable assurance did ASIC accept a Court Enforceable Undertaking?
6. In how many cases where ASIC formed the view that an auditor did not obtain reasonable assurance did ASIC begin court proceedings?
7. In how many cases where ASIC formed the view that an auditor did not obtain reasonable assurance did this result in an auditor voluntarily cancelling their registration?
8. Is there anything preventing ASIC from publishing the audit inspection report for each firm in full? Why doesn't ASIC publish the audit inspection report for each firm in full?
9. Is there anything preventing ASIC from publishing the names of entities identified in an individual firm's audit inspection reports whose audits received an adverse finding? Why doesn't ASIC publish the names of entities whose audits receive an adverse finding?

10. In cases where ASIC forms the view that an auditor has not obtained reasonable assurance, does ASIC establish whether: an audit firm also provided other assurance or non-assurance work for that entity; and the value of any non-audit work? Please provide details, if possible the number of files that attracted an adverse finding in each of ASIC's audit inspection reports where the audit firm also provided non-audit work for the entity in question.

Report 648 – Audit inspection report for 2018-19

1. For each of the six time periods listed in Table 1 of Report 648, relating to individual audit inspection reports:
 - a. What number of key audit areas reviewed attracted an adverse finding?
 - b. What number of files were reviewed?
 - c. What number of files that were reviewed attracted an adverse finding, in part or as a whole?

APES 110 Code of Ethics for Professional Accountants

APES 110 requires auditors to be independent, including in appearance, which is defined as: The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a Firm's or an Audit or Assurance Team member's integrity, objectivity or professional scepticism has been compromised.

1. For each of the last five years, on how many occasions has ASIC identified an auditor to be in breach of the independence requirements of APES 110?
2. When ASIC reaches the view that an auditor is not independent:
 - a. What enforcement action does ASIC take?
 - b. Does ASIC inform investors in the audited entity?
3. Does ASIC have 'practice notes' to guide its assessment of whether an auditor is independent?

Audit failures

1. What analysis does ASIC undertake of the quality of audits where a company goes into receivership? In other words: does ASIC use corporate collapses as an opportunity to identify the nature and scale of any problematic audit practices?

Corporations Act 2001 Section 307A: Audit to be conducted in accordance with auditing standards

1. If an auditor does not obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error:
 - a. The audit is not in accordance with the auditing standards, except in circumstances where the auditor issued a qualified audit opinion or, if that is not sufficient, disclaimed an opinion or resigned from the engagement (see paragraphs 11 and 12 of auditing standard ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*); and
 - b. Where the auditor has not met the requirements described above, this would, *prima facie*, constitute a breach of Section 307A of the Act.
2. When ASIC reaches the view that an auditor did not obtain reasonable assurance that the financial report was free of material misstatement:
 - a. ASIC will consider whether to take enforcement action, which may include referring the auditor to the Companies Auditors Disciplinary Board (CADB) (formerly the Companies Auditors and Liquidators Disciplinary Board) or commencing Court proceedings. The prosecution of most Corporations Act 2001 criminal offences is undertaken by the Commonwealth Director of Public Prosecutions following referral of a brief of evidence from ASIC. In any case the question of whether the evidence is sufficient to prove any allegations will be key.
 - b. ASIC is authorised to disclose audit related confidential information to the directors, audit committee or senior managers of an audited entity under s127(2D) of the Australian Securities and Investments Commission Act 2001 (the ASIC Act). This includes disclosing ASIC's concerns with an audit arising from our review of an auditor's working papers relating to the audit of the entity. ASIC Regulatory Guide 260 *Communicating findings from audit files to directors, audit committees or senior managers* (RG 260) outlines our policy on the use of s127(2D) of the ASIC Act. A copy of RG 260 is attached.

Paragraphs RG 260.29 and RG 260.30 outline our policy for disclosing from the review of audit working papers where we intend to take enforcement action:

“Potential enforcement action

RG 260.29 While we may not disclose to the directors of the entity that we intend to take enforcement action against an entity's auditor, we will communicate our findings to the entity where the findings are relatively severe.

RG 260.30 In these circumstances, and taking the particular facts into account, we may inform the directors of the entity of audit

deficiencies so that they can consider appropriate action (e.g. seeking the resignation or removal of the auditor).”

ASIC may inform the directors, audit committee or senior managers of an audited entity of concerns with the audit under s127(2D) of the ASIC Act before commencing any enforcement action. In particular, RG 260 provides guidance on when we will communicate concerns from the review of audit working papers as part of audit firm inspections and auditor surveillance activities.

3. ASIC Information Sheet 151 *ASIC’s approach to enforcement* publicly outlines our general approach to enforcement and discusses how we respond to matters taking into account considerations such as:

- Strategic significance (e.g. what is the extent of harm or loss?);
- Benefits of pursuing misconduct (e.g. is enforcement cost-effective?);
- Issues specific to the case (e.g. what evidence is available?); and
- What enforcement tools are available.

A new internal guide for assessing auditor related matters is being developed having regard to ASIC’s ‘why not litigate’ approach and experience from current audit matters under investigation.

Note also that the objective under ASIC’s Enforcement Strategy for 2019-2021 is to identify, prioritise and act quickly and decisively on the most important enforcement within ASIC to obtain criminal and civil court based outcomes that discourage and punish misconduct. One of the priorities of ASIC’s new Office of Enforcement for 2019-2021 is auditor misconduct. In order to further this priority, ASIC is pursuing as a priority several current investigations in relation to auditor misconduct, which investigations include a focus on pursuing criminal and or civil liability for relevant auditor misconduct.

4. In the years 2010 to 2018, ASIC referred four cases to the Companies Auditors Disciplinary Board (CADB) (formerly the Companies Auditors and Liquidators Disciplinary Board) in circumstances where we were of the view that a registered company auditor did not obtain reasonable assurance that the financial report was free of material misstatement and the auditor did not issue a qualified audit report or disclaimer of opinion. In a number of other cases CADB referrals were at an advanced stage but ultimately not lodged as the auditor offered a Court Enforceable Undertaking or voluntarily cancelled their registration.
5. In the years 2010 to 2018, ASIC accepted Court Enforceable Undertakings in 15 cases in circumstances where we were of the view that a registered company auditor did not obtain reasonable assurance that the financial report was free of material misstatement and the auditor did not issue a qualified audit report or disclaimer of opinion.
6. In the years 2010 to 2018, ASIC did not begin court proceedings on any matters where ASIC formed the view that an auditor did not obtain reasonable assurance that the financial report was free of material misstatement and the auditor did not issue a qualified audit report or disclaimer of opinion. In a number of cases Court proceedings were being considered but were ultimately not lodged as the auditor offered a Court Enforceable Undertaking or voluntarily cancelled their registration.
7. In the years 2010 to 2018, three auditors voluntarily cancelled their registrations in cases where ASIC had formed a preliminary view that an auditor did not obtain reasonable

assurance that the financial report was free of material misstatement and the auditor did not issue a qualified audit report or disclaimer of opinion.

8. There are restrictions on publishing the relevant information. The audit inspection reports for each firm contain confidential information, being information obtained by ASIC exercising its powers, or otherwise given to it in confidence in connection with the performance of ASIC's functions. Section 127(1) of the ASIC Act provides that ASIC must take all reasonable measures to protect confidential information from unauthorised use or disclosure, and only authorises disclosure of that information in specific circumstances.

Relevantly, using or disclosing information with the consent of the person who provided it is authorised (s127(3A)), as is disclosure of information by a person for the purposes of performing the person's functions as a member, staff member, or an ASIC delegate (s127(3)(a)).

We recognise that transparency through publishing the individual firm audit inspection reports can play an important role in advancing ASIC's statutory objectives. In future, we will consider the possibility of directly publishing audit inspection reports relying on the authorisations in s 127 noted above.

We note that the largest four audit firms in Australia have already voluntarily published the individual firm audit inspection reports for the 12 months to 30 June 2019 and most had published the reports for the 18 months to 30 June 2018.

9. There are restrictions on publishing the relevant information. The same ASIC Act provisions mentioned in response to question 8 operate in relation to the identification by ASIC of entities whose audits receive an adverse finding.

We consider the extent to which transparency through identifying entities in ASIC's public reports can play an important role in advancing ASIC's statutory objectives. In future, we will consider the possibility of identifying entities relying on the authorisations in s 127 noted above. However, we are also conscious of the potential negative impact on confidence in a company from this kind of public disclosure, even though there may be no misstatement of their financial report.

At present, the UK Financial Reporting Council (UK FRC) appears to be the only major audit regulator globally to name the entities whose audits were subject to review by the regulator. The UK FRC does not identify the entities for which there were adverse audit inspection findings.

10. When ASIC reviews audit files in audit firm inspections and audit surveillances, ASIC obtains and assesses information regarding non-audit services provided by the firm to the audited entities. The information includes:

- the nature of the services provided;
- the amount;
- percentage to audit fee;
- names of the partners provided the services; and
- the engagement acceptance assessment which considers any potential conflict of interest.

We reconcile the information to the signed financial report and obtain explanations from the auditor where significant variances are noted, or there are any potential concerns

about compliance with auditor independence requirements under the *Corporations Act 2001*, including the professional Code of Ethics.

The information is considered and recorded at the individual audit file review level and not aggregated for each audit inspection cycle.

For the last two inspection periods the table below shows the number of files with adverse findings and whether the audit firm provided non-audit services for the relevant financial year.

Period	No. of files with adverse findings	No. of files with adverse findings where the audit firm also provided non-audit services
18 months to 30 June 2018	53	46
12 months to 30 June 2019	33	25