



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **7**

Meeting Date: 28 November 2011

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

Date Prepared: 3 November 2011

Action Required

For Information Purposes Only

Agenda Item Objectives

To provide the AUASB with a high-level overview of proposed legislative reforms to:

1. The *Corporations Act 2001*; and
2. The *Australian Securities and Investments Commission Act 2001*.

Background

The objectives of the draft legislation are to “help improve audit quality and deliver greater transparency and reliability” [Parliamentary Secretary to the Treasurer].

The draft Bill is the product of industry consultation – achieved through responses to Treasury’s consultation paper *Audit Quality in Australia: A Strategic View*. The overall conclusion in Treasury’s paper is that Australia’s audit regulation framework is robust and stable, that the framework is in line with international best practice and that no fundamental changes to the framework are required.

The proposed amendments will implement important reforms to enhance audit quality and ensure that Australia’s regulatory framework remains in line with international best practice.

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Matters to Consider

Following is an outline of the topics included in the proposed legislation and the key features of those topics:

Amendments to the *Corporations Act 2001*

1. Auditor Rotation

The Bill retains the five year mandatory auditor rotation period but introduces more flexibility to allow the directors of a listed company or listed registered scheme to extend the rotation period for up to two years provided the directors comply with specified requirements designed to protect auditor independence and safeguard the quality of the audit.

An audit committee's recommendation to the directors to grant approval for an extension is subject to the following requirements:

- the recommendation must be endorsed by a resolution passed by the members of the audit committee;
- the recommendation must state that the audit committee is satisfied that the approval:
 - is necessary to safeguard the quality of the audit provided to the company or scheme;
 - would not give rise to a conflict of interest situation as defined in section 324CD of the *Corporations Act 2001*; and
- the recommendation must be in writing and given to the directors, giving the reasons why the audit committee is satisfied that the extension is necessary to safeguard the quality of the audit and that it will not give rise to a conflict of interest situation.

Within 14 days of granting the approval, the directors are required to give a copy of the resolution granting the approval to:

- the Australian Securities and Investments Commission (ASIC); and
- the individual auditor who is subject to the extension of the rotation requirement or where the auditor acts on behalf of an audit firm or audit company, to the firm or company.

Compliance cost impact: The amendments may reduce the compliance costs for audit firms in managing their audit partner rotation systems.

Impact: The auditor rotation measures will impact on listed companies and listed registered schemes and the auditors who provide audits for those listed entities.

2. Annual Transparency Reports

The Bill introduces a requirement for the publication of an annual transparency report by firms conducting audits of ten or more Australian entities of the following categories: listed companies, listed registered schemes, authorised deposit-taking institutions (ADIs) and insurance companies.

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The Bill introduces a requirement for the publication of an annual transparency report by firms conducting audits of ten or more Australian entities of the following categories: listed companies, listed registered schemes, authorised deposit-taking institutions (ADIs) and insurance companies.

Requiring audit firms to publish a transparency report will ensure factual information about firms performing significant audits, is available to existing and potential clients.

Compliance cost impact: Compliance costs associated with the publication of a transparency report are expected to be low because the information required would already be available to each of the firms subject to the requirement. The quantum of these costs will vary depending on the size of the firm, the structure under which the firm operates in Australia and the ability of the firm to draw on the resources of international associates when preparing the report.

Amendments to the ASIC Act 2001

1. Auditor Independence Functions

The Bill streamlines the auditor independence work of ASIC and the FRC by removing the existing auditor independence function from the FRC and, in its place, giving the FRC a role of providing the Minister and the professional accounting bodies strategic policy advice and reports in relation to the quality of audits conducted by Australian auditors.

Stakeholders considered that making this change would remove the duplication between the 'operational' nature of the FRC's existing function and ASIC's audit inspection program.

Compliance cost impact: The amendments are expected to reduce the administrative costs currently incurred by the FRC in carrying out the auditor independence functions. Costs incurred by stakeholder bodies in respect of meetings with the FRC may also be reduced.

Impact: The changes to the FRC's auditor independence functions will impact primarily on the Government and regulators (particularly ASIC and FRC). Some stakeholders, such as audit firms, are expected to experience a reduction in the level of burden the current arrangements place on them.

2. Audit Deficiency Notifications and Reports

ASIC is currently prohibited from publishing information about an audit deficiency in relation to an individual audit firm because of the confidentiality restrictions in section 127 of the ASIC Act. However, in a number of important overseas jurisdictions, the independent audit regulator is permitted to make public disclosure about defects in an individual audit firm's quality control systems, subject to appropriate natural justice protections.

The proposed reporting model gives ASIC the power to prepare and publish a report on an individual audit firm where the firm has failed to take steps to satisfactorily address an audit deficiency identified by ASIC within six months of notification by ASIC.

ASIC is given the power to issue an audit deficiency report in relation to specified failures by the audit firm that ASIC has identified during the exercise of its statutory audit functions:

- a failure by the auditor to comply with the auditing standards;
- a failure by the auditor to comply with the auditor independence requirements in the Corporations Act;

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- a failure by the auditor to comply with any applicable code of professional conduct; or
- a failure by the auditor to comply with the provisions of the Corporations Act dealing with the conduct of audits.

The reporting model provides a strong incentive for an audit firm to take appropriate remedial action without imposing any significant additional costs on either ASIC or the audit firm.

Compliance cost impact: The amendments should not impose any significant additional costs on either ASIC or Australian auditors

Impact: The audit notification and report measures will impact on ASIC and Australian auditors that fail to remedy an audit deficiency identified by ASIC after six months from notification by ASIC.

3. Communications with Corporations, Registered Schemes and Disclosing Entities

ASIC has explained that it was placed in a difficult position where it became aware of significant matters affecting the audit of a company during the inspection or surveillance of an audit firm and yet it was unable to disclose this to the audited body or its audit committee. ASIC is prevented from making such disclosures to the audited body or its audit committee without the audit firm's consent because of the confidentiality requirements in section 127 of the ASIC Act.

ASIC's inability to communicate quickly to the audited body (or its audit committee) about defects in either the conduct of the audit or matters relating to the company's accounting or disclosure practices inhibits the audited body and the board of directors from fulfilling their obligations.

The amendments allow ASIC to disclose information to the directors, the audit committee or a senior manager of a company, responsible entity or disclosing entity concerning the conduct of the audit or compliance by the audited body with the requirements in Chapter 2M to prepare financial statements and reports, or with the continuous disclosure requirements of sections 674 and 675 of the Corporations Act. The information that is authorised to be disclosed must have been obtained by ASIC in the course of the exercise of its functions and powers in relation to audit

Compliance cost impact: The amendments should not impose any significant additional costs on ASIC, audited bodies or Australian auditors.

Impact: The measures will impact on ASIC, audited bodies (and their audit committees) and Australian auditors.

Material Presented

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