



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 260

Communicating findings from audit files to directors, audit committees or senior managers

June 2017

About this guide

This guide is for audit firms as well as the directors, audit committees and senior managers of companies, responsible entities or disclosing entities.

It explains which financial reporting and audit quality findings identified from our reviews of audit files we would generally communicate to directors, audit committees or senior managers. It also provides guidance on the process we will follow and the timing of our communication.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This guide was issued in June 2017 and is based on legislation and regulations as at the date of issue.

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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A Overview

Key points

The *Australian Securities and Investments Commission Act 2001* (ASIC Act) allows the direct communication of specific financial reporting and audit quality findings identified from our reviews of audit files, to directors, audit committees or senior managers of companies, responsible entities or disclosing entities.

This guide is intended to provide guidance on:

- our criteria for communicating financial reporting and audit quality findings identified from our reviews of audit files (see Section B);
- the process we will follow (including for meeting our procedural fairness obligations) and the timing of communicating financial reporting and audit quality findings to directors, audit committees or senior managers (see Section C); and
- our rationale for advising directors of our routine audit file reviews and the timing of this communication (see Section D).

ASIC's ability to communicate financial reporting and audit quality findings

- RG 260.1 Section 127(2D) of the ASIC Act allows the ASIC Chairperson to communicate both financial reporting findings and audit quality findings identified from our reviews of audit files, directly to directors, audit committees or senior managers of a company, responsible entity or disclosing entity to assist the entity to properly manage its affairs.
- RG 260.2 We will communicate findings from our review of the audit file based on the criteria set out in Section B, on an exception basis rather than communicating all findings. We will generally provide the auditor concerned with at least seven days notice before communicating the information.
- RG 260.3 The information disclosed to the entity must be about:
- (a) how the audit of the entity was conducted by an Australian auditor; or
 - (b) the entity's compliance with:
 - (i) the requirements in Ch 2M of the *Corporations Act 2001* (Corporations Act) to prepare financial statements and reports; or

- (ii) the continuous disclosure requirements of s674 and 675 of the Corporations Act.

- RG 260.4 We do not always need to rely on s127(2D) of the ASIC Act to communicate information. This is the case if no confidential information would be disclosed. In addition, section 127(3A) allows us to disclose confidential information where we obtain the consent of the auditor.
- RG 260.5 While we have not used the ability under s127(2D) of the ASIC Act to communicate findings from our reviews of audit files to directors, audit committees or senior managers on a routine basis, the existence of this ability has assisted us, in numerous cases, to work cooperatively with audit firms to contact entities where we have had significant concerns about their financial reports.
- RG 260.6 We understand that some audit firms only communicate the findings from our review of audit files when requested to do so by the entity audited. However, as a matter of general practice, most audit firms inform directors when ASIC will be reviewing audit files.
- RG 260.7 [Information Sheet 196](#) *Audit quality—The role of directors and audit committees* (INFO 196) encourages audit committees to ask audit firms for the results of our reviews of audit files for an entity.
- RG 260.8 Our ability to report financial reporting findings, and to report audit quality findings to directors, audit committees or senior managers under s127(2) of the ASIC Act is separate from our ability to issue an audit deficiency report under s50C of ASIC Act. This guide does not apply to the publication of audit deficiency reports under s50C.

Criteria for communicating findings

- RG 260.9 In Section B of this guide, we give guidance on our criteria for determining which financial reporting findings, and which audit quality findings identified from our reviews of audit files, we would disclose to directors, audit committees or senior managers of the entities concerned.
- RG 260.10 We explain our criteria for communicating findings where we have significant concerns that the financial statements may be materially misstated based on information on the audit file.
- RG 260.11 This section also sets out our criteria for communicating audit quality findings in certain cases where:
- (a) the auditor has not, in our view, obtained reasonable assurance that the financial report is free of material misstatement;

- (b) our findings about audit quality from previous years have not been addressed by the auditor;
- (c) the auditor has not met independence requirements;
- (d) we intend to take enforcement action against the auditor; or
- (e) we have other concerns about audit quality.

ASIC's process and timing of communication

- RG 260.12 Our practice is to work cooperatively with audit firms to contact entities where we have significant concerns about aspects of their financial reporting based on information on an audit file.
- RG 260.13 Section C of this guide explains the process we will follow (including for meeting our procedural fairness obligations) and the timing of communication to the directors, audit committees or senior managers of an entity about financial reporting, and about audit quality findings identified from the review of an audit file.

Advising directors of our routine audit inspections

- RG 260.14 Section D of this guide provides guidance on our approach to communicating to the board of directors of an audited entity that we will be reviewing audit files relating to the entity as part of our routine audit firm inspections.
- RG 260.15 We will notify the directors of our planned file review five business days after we have informed the audit firm. We encourage directors to seek information directly from their auditors about any issues or concerns that may be identified in our review.

B Communicating financial reporting and audit quality findings

Key points

This section provides guidance on our rationale and criteria for communicating financial reporting findings, and communicating audit quality findings identified from our review of audit files, to directors, audit committees or senior managers, of companies, responsible entities or disclosing entities.

Rationale for communicating findings

- RG 260.16 Directors have primary responsibility for the quality of financial reporting. The quality of financial reports is supported by the quality of the independent audit. Directors cannot simply rely on the work of the auditor and should ensure that an entity has adequate systems and processes to ensure quality financial reports. Directors should also support and promote high quality independent audits in the interests of investor and market confidence.
- RG 260.17 Our rationale for communicating both financial reporting and audit quality findings that we identify from audit files is to assist directors to:
- (a) take action to address deficiencies in an entity's financial report;
 - (b) improve systems and processes supporting financial reporting; and
 - (c) engage with the auditor about steps the auditor will take to improve audit quality.
- Note: See [INFO 196](#).
- RG 260.18 This rationale reflects the requirement in s127(2D)(c) of the ASIC Act that the relevant information disclosed should assist the entity to properly manage its affairs.
- RG 260.19 If an auditor does not address deficiencies in their audit, the directors may seek the resignation or removal of the auditor.

Focuses of our audit inspections and financial reporting surveillances

- RG 260.20 Our audit inspections and financial reporting surveillances:
- (a) predominantly focus on recognition and measurement issues involving potential material misstatements of profits and net assets—arising from accounting policy choices and estimates (e.g. asset values)—rather than disclosure issues;
 - (b) exclude matters that, in our view, are within a range of reasonable judgement; and
 - (c) exclude matters that, in our view, concern genuine issues about the interpretation of the accounting and auditing standards, which may be matters for the relevant international and local standards-setting body or interpretations committee.

Criteria for communicating financial reporting findings

Material misstatements in financial reports

- RG 260.21 To support quality financial reporting and confident and informed investors and markets, we will communicate to directors, audit committees or senior managers of an entity where we have identified concerns, from our review of an audit file, that the entity's financial report is materially misstated. We will consider referring to specific information from the entity's records contained on the audit files that may assist in addressing the matter more efficiently and on a more timely basis.
- RG 260.22 Section C explains the process we will follow before communicating to directors, audit committees or senior managers any specific financial reporting findings identified from our reviews of audit files. Where confidential information from the audit file would be disclosed, such matters may be communicated under s127(2D) of the ASIC Act, or with the auditor's consent (s127(3A)).

Criteria for communicating audit quality findings

Failure to obtain reasonable assurance

- RG 260.23 We will communicate audit quality findings identified from our reviews of audit files to directors, audit committees, or senior managers of the entities concerned on an exception basis having regard to our criteria, rather than communicating all findings.

RG 260.24 We will communicate findings where we have formed the view that an auditor has not obtained reasonable assurance that an entity's financial report is free of material misstatement and considering all or some of the following:

- (a) the relative severity of the matters, assessed on a case by case basis taking into account all relevant facts and circumstances, including our assessment of the nature and extent of findings, possible impact and the probability of that impact occurring, and whether there are findings across a number of key audit areas. (For example, whether the financial report has already been restated and, if not, the likelihood of an actual material misstatement in the financial report, and the potential market impact of such a misstatement);
- (b) whether the auditor can demonstrate that they have already satisfactorily communicated the matter in writing to the entity's audit committee or directors in a comprehensive manner;
- (c) whether the audit firm has already remediated our concerns by performing the necessary audit work for the year of the audit in question;
- (d) if the matter has not already been remediated, whether the auditor has:
 - (i) committed to adequately addressing the issues in a timely manner,
 - (ii) definite plans in place to address the issues; and
 - (iii) a history of satisfactorily addressing such issues;
- (e) whether the issues affect a number of entities; and
- (f) whether there is, in our view, genuine uncertainty about the level of audit work required by the auditing standards or accounting standards.

RG 260.25 Our criteria in RG 260.24 are based on the objective of an audit—as set out in the auditing standards having the force of law under the Corporations Act—that is, to obtain reasonable assurance that a financial report is free of material misstatement. The auditing standards provide a framework to support the application of our criteria, and are the basis we use for measuring audit quality. This basis for measuring audit quality is also used by the International Forum of Independent Audit Regulators and most other international audit oversight regulators.

Addressing findings from previous years

- RG 260.26 We will also consider communicating findings where:
- (a) we notified an auditor that we were concerned that they did not obtain reasonable assurance that an entity's financial report was free of material misstatement in a previous year;
 - (b) in our view, the finding is relatively severe (see criteria in RG 260.24(a); and
 - (c) our review of a subsequent audit reveals that our concerns have not been addressed.

Assessment of independence requirements

- RG 260.27 We will disclose findings where we have concerns that the auditor of an entity does not meet the independence requirements of the Corporations Act (including professional requirements), has not addressed the matter, and cannot demonstrate that it has already satisfactorily communicated the matter in writing to the directors or in the auditor's required independence declaration.
- RG 260.28 Communicating these findings may assist the directors and audit committees to consider the independence of the auditor when recommending the appointment of auditors, and on an ongoing basis.

Note: See [INFO 196](#).

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).

Other concerns we may communicate

- RG 260.31 We may disclose information from audit files to directors, audit committees or senior managers where we have other concerns that, for example:
- (a) the entity does not produce, under notice, information that we have seen on the audit files;
 - (b) information available to the auditor and to the directors is inconsistent; or
 - (c) the directors may not be aware of relevant information concerning an offshore subsidiary.
- RG 260.32 We will undertake an appropriate process (including for meeting our procedural fairness obligations) before disclosing any information that is provided to us by the auditor (see Section C).
- RG 260.33 We will consider whether other domestic and international regulators, such as the Australian Prudential Regulation Authority (APRA) or the Australian Taxation Office (ATO) should be advised of findings from our reviews of audit files.

C Process and timing of communication

Key points

This section explains our process for, and timing of, our communication to directors, audit committees or senior managers of financial reporting and/or audit quality findings that we identify from our reviews of audit files.

We will aim to work with audit firms to ensure our findings are communicated to entities where we have significant concerns about their financial reports. Where necessary, we will use our statutory ability to disclose information.

Confidentiality

RG 260.34 Under s127(1) of the ASIC Act, we must take reasonable measures to prevent unauthorised use and disclosure of information we receive in confidence in connection with our statutory functions: s127(1). Certain uses and disclosures are taken to be authorised (s127(2)–(6)). [Regulatory Guide 103 Confidentiality and release of information](#) (RG 103) deals generally with disclosures by ASIC under s127 and how we carry out our procedural fairness obligations for such disclosures. This guide focuses on our disclosures under s127(2D) and should be read in conjunction with RG 103.

Financial reporting matters

RG 260.35 In addition to routine audit inspections, we also carry out financial reporting surveillances. If we identify preliminary concerns through our financial reporting surveillance program that the financial report of an entity might be materially misstated, we will seek any information or explanations directly from the relevant entity. We will generally provide a copy of our initial inquiry letter to the entity's auditor. If the letter to the entity contains confidential information, we will instead advise the auditor that such a letter has been sent to the entity.

RG 260.36 If we have also reviewed the audit file, we may consider it necessary to include confidential information from the audit file in our letter to the entity. We will do so with the cooperation and consent of the auditor, relying on s127(3A) of the ASIC Act, or we will rely on s127(2D).

- RG 260.37 Where we have concerns from our review of the audit files that an entity's financial report could be materially misstated, we will disclose these findings directly to the entity's audit committees, directors or senior managers, so that appropriate actions can be taken immediately: see RG 260.21–RG 260.22).
- RG 260.38 We will work cooperatively with the auditor to communicate matters to the entity. Where we believe that a matter should be communicated to the entity's directors, audit committee or senior managers and the auditor does not consent to disclosure of confidential information, we may use our ability under s127(2D) of the ASIC Act to communicate directly with the entity. In these cases, we will give the auditor reasonable opportunity to explain to us whether or not they believe we should disclose information to the entity's directors, audit committee or senior managers. If we are proposing to disclose information about how the audit was conducted, we will generally provide the auditor with at least seven days notice: s127(2F). If the auditor provides such reasons, we will consider them when deciding whether to communicate the information to the entity.
- RG 260.39 In our communication to the entity, we will not refer to any confidential information on the audit work papers prepared by the auditor unless they relate to matters covered under RG 260.24–RG 260.31 or would otherwise assist the entity to properly manage its affairs.
- RG 260.40 We will generally only refer to information on the audit file that has been provided by the entity to the auditor (e.g. impairment testing model and related assumptions) or information that the auditor has communicated to the company or directors (e.g. Board Audit Committee report or management letters etc.).
- RG 260.41 In some circumstances, we may need to provide the auditor with a shorter period to make submissions on a proposed disclosure than would generally apply, in the interests of ensuring that a matter is resolved and the market is properly informed on a timely basis. This may be due to the particular financial circumstances of the entity, or the timing of its next financial report, for example.
- RG 260.42 While some matters may be noted in the auditor's report to members, and as part of the auditor's communications to directors, this does not necessarily mean that such matters have been dealt with adequately.
- RG 260.43 If, in our view, there are significant and genuine disagreements regarding interpretation of accounting standards, we may consult with the relevant international and local standards-setting bodies or

interpretation committee rather than disclose a matter to the entity's audit committees, directors or senior managers.

Audit quality matters

- RG 260.44 We review audit files as part of our inspections of a firm regularly throughout the year. At the end of every 18 months, we generally issue confidential reports to each firm covering all findings from reviews substantially completed in that period.
- RG 260.45 We communicate findings from each review to a firm in writing as we conduct our individual audit file reviews, rather than wait for the completion of our confidential report.
- RG 260.46 We may communicate matters that we have identified from reviews of audit files concerning the quality of an audit to directors, audit committees or senior managers before completing our confidential report.
- RG 260.47 We also conduct auditor surveillance activities on a case by case basis where, for example, we have intelligence about potential audit deficiencies or auditor misconduct.
- RG 260.48 Delaying communications with directors, audit committees or senior managers may not be in the interests of audit quality, particularly where a past audit should be remediated or a subsequent audit may be affected.
- RG 260.49 We will endeavour to work cooperatively with the auditor to communicate audit quality matters to the entity. We endeavour to give the auditor appropriate opportunities to respond to our findings.
- RG 260.50 Where we propose to disclose findings about how an audit was conducted, we will provide the auditor with at least seven days notice: s127(2F). The auditor may make a submission during this period about whether or not they believe we should make the proposed disclosure. If the auditor provides a submission, we will consider it when deciding whether to disclose the information.
- RG 260.51 Where the auditor does not respond to our notice of proposed communication in a reasonable time, we may communicate information to the entity's directors, audit committee or senior managers without a response. However, we will generally first try to ascertain whether there are reasons for a delayed response and consider any such reasons.
- RG 260.52 The fact that an auditor disagrees with our findings is not necessarily sufficient reason for us to not communicate a matter to

the entity's directors, audit committee or senior managers. However, we will consider any concerns expressed by the auditor when deciding whether to communicate a matter. We may discuss our intention to communicate a matter with the senior leadership of an audit firm.

- RG 260.53 Where we decide to communicate matters to entities after considering any concerns raised by the auditor, we will include a summary of the auditor's response on the matter in our communication to the entity.
- RG 260.54 If, in our view, there are significant and genuine disagreements regarding interpretation of auditing standards, we may consult with the relevant international and local standards-setting bodies and interpretation committees rather than communicate a matter to the company's audit committees, directors or senior managers.

D Advising directors of routine file review

Key points

This section explains the rationale for, and timing of, our communication to directors, audit committees and senior management that we will be reviewing audit files relating to the entity as part of our routine audit firm inspections.

Rationale

- RG 260.55 Most audit firms notify companies when their audit files are subject to an ASIC inspection. However, this guide formalises the process so that, in all circumstances, we will notify the directors of entities that we intend to review the audit files relating to that entity.
- RG 260.56 Timely communication to the directors that ASIC will be reviewing audit files relating to their entity will enable the directors to seek information directly from their auditors about any issues and concerns arising from our review.
- RG 260.57 Such information will enable the directors to ask the auditor about the steps they are taking to:
- (a) address any issues and concerns;
 - (b) improve audit quality; and
 - (c) support investor and market confidence in the quality of financial reports.
- RG 260.58 Although our selection of audit files for review may be risk based, the selection of an audit file for review should not be taken to suggest that the financial report or the work of the auditor is inadequate.

Timing of communication

- RG 260.59 We generally inform audit firms of our planned routine inspection of audit files at least 10 business days before we commence our reviews. We will also inform the company of our planned review five business days after we have informed the audit firm.

Key terms

Term	Meaning in this document
accounting standards	Standards issued by the Australian Accounting Standards Board under s334 of the Corporations Act
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i>
audit firm	A firm that consents to be appointed, or is appointed, as auditor of a company or registered managed investment scheme, and a firm that audits a disclosing entity
audit inspection program	ASIC's program of proactive reviews of audit files and audit firm quality controls for compliance with auditing requirements of the Corporations Act
auditor surveillance	Reactive reviews by ASIC of audit files based on intelligence and possible concerns about audit quality
financial reporting surveillance program	ASIC's program of proactive reviews of financial reports of selected listed companies and other public interest entities for compliance with financial reporting requirements of the Corporations Act
auditing standards	Standards issued by the Auditing and Assurance Standards Board under s336 of the Corporations Act
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of the Act
financial report	A full-year or half-year financial report required under Pt 2M.3 of the Corporations Act
INFO 196 (for example)	An ASIC information sheet (in this example numbered 196)
s127(2F) of the ASIC Act (for example)	A section of the ASIC Act (in this example numbered 127(2F), unless otherwise specified)
s674 of the Corporations Act (for example)	A section of the Corporations Act (in this example numbered 674), unless otherwise specified

Related information

Headnotes

audit findings, auditor, audits, audit firms, communicating audit findings, process, financial reporting, inspection, material misstatement, surveillance, timing

Regulatory guides

[RG 103](#) *Confidentiality and release of information*

Legislation

ASIC Act, s127(1), s127(2), s127(2D), s127(2D)(c), s127(2F), s127(3A)

Corporations Act, Ch 2M, s674, s675

Consultation papers and reports

[CP 265](#) *Communicating audit findings to directors, audit committees or senior managers*

Information sheets

[INFO 196](#) *Audit quality—The role of directors and audit committees*