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Attention: Mr. Channa Wijesinghe
The Hon Nicola Roxon
Chairman
Accounting Professional & Ethical Standards Board Limited
Level 11, 99 William Street
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Our ref APES18-RoxonN_SubmissionE&PA0814-
MYL

Contact Mark Jones (+61 3 9288 5790)

14 August 2018

Dear Ms Roxon

Submissions – ED 02/18 and ED 03/18 Proposed Standard: APES 110 Code of Ethics for Professional Accountants (including Independence Standards)

We value the opportunity to provide comments to the Accounting Professional and Ethical Standards Board (**APESB**) regarding proposed changes to the APES 110 Proposed Standard: APES 110 Code of Ethics for Professional Accountants (including Independence Standards) (the **Code**). KPMG is generally supportive of the proposed revised Code.

We note that KPMG has participated in discussions with representatives from Chartered Accountants Australia and New Zealand (**CA ANZ**) on this matter and have provided input into the submission that has been made by CA ANZ to the APESB.

However, while not specifically related to the structure of the Code, we believe it is appropriate to raise a suggested amendment to the Code in order to address an existing anomaly between the Code and the Corporations Act 2001, as amended (Cth) (**Corporations Act**).

APES 110 (290.108) – Financial interest breach involving a ‘Partner in the Office’ and the implications for the Corporations Act

- A breach of APES 110 (290.108) occurs when a Partner in the same office in which the Engagement Partner practices in connection with the Audit Engagement, or their immediate family, holds a financial interest in that audit client.
- We note that while this does not represent a breach of the Corporations Act, the legislation requires the issuance of a qualified section 307C declaration, as there would be a ‘contravention of any applicable code of professional conduct in relation to the audit’.
- In this scenario, we do not believe that the quality control system defence available in the Corporations Act (section 324CF(4)), which would not require the issuance of a qualified section 307C declaration, can be relied upon. This defence is only applicable to ‘the requirements of this Subdivision’. In particular, the rule that is breached (i.e. the APES 110 ‘Partner in the Office’ rule) is not in the relevant Subdivision (as the rule is not in the Corporations Act at all). Hence, the quality control defence could not be used.

- However, it is acknowledged by many that this concluded position is unintended i.e. a 'Partner in the Office' breach requires a qualified section 307C, however, no qualified section 307C is typically required if a breach was caused by a member of the audit team.

We believe that this anomalous outcome was not intended by the legislature.

In 2007, the legislature introduced subsection 307C(5B) of the Act as part of a package of reforms to address what the legislature described as 'Anomalies arising from CLERP 9'.¹ One anomaly identified was that section 307C of the Act would require an auditor to declare inadvertent breaches of the auditor independence requirements notwithstanding that a statutory defence applied. The Explanatory Memorandum to the Bill states:²

In the course of day-to-day audit practice, there would be many examples of inadvertent breaches of the auditor independence requirements which would be quickly addressed once the auditor became aware of the breach.

...

The measures in the Bill will ensure that an auditor will not be required to report inadvertent breaches of the auditor independence requirements in the auditor's declaration where the statutory defence would be applicable.

Prior to the introduction of subsection 307C(5B), relief in such circumstances was provided under ASIC class order 05/910.

Importantly, and essential to understanding the anomaly that it creates, subsection 307C(5B):

- **'carves-out'** from the section 307C disclosure requirement conduct that while in breach of auditor independence requirements in the Act – is conduct for which certain statutory defences are able to be established;
- **but does not 'carve-out'** breaches of any applicable code of professional conduct (such as APES 110), even where those breaches are inadvertent.

Relevantly, it is an offence under subsection 324CF(2) of the Act for a professional member of the audit team to have an asset that is an Investment in an audit client.³ A statutory defence to that offence is available under subsection 324CF(4) if there were reasonable grounds to believe that the auditor had in place at the time a quality control system that provided reasonable assurance that the auditor and its employees complied with the requirements of Subdivision 3B of Part 2M.4 of the Act.

¹ Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007; Explanatory Memorandum to the Bill, p60.

² At pp62 – 63.

³ Section 324CF(2), because item 10 of the table in subsection 324CH(1) would have applied at that time to a person covered by item 4 of the table in subsection 324CF(5).

Therefore, as a result of the introduction of section 307C(5B), if rather than another Partner in the office of the Engagement Partner making the Investment, the Investment had been made by a professional member of the audit team (including the Engagement Partner):

- that would be a contravention of subsection 324CF(2) of the Act; and
- the defence in subsection 324CF(4) would apply; and, consequently
- subsection 307C(5B) would apply so that the auditor would not be required to give a declaration under section 307C in respect of the contravention of the Act.

However, whilst it is a breach of paragraph 290.108 for a partner who is not a professional member of the audit team of an audit client, but who is based in the same office as the Engagement Partner for the audit, to have an asset that is an Investment in an audit client, it is not an offence under the Act. Therefore:

- the defence under subsection 324CF(4) cannot apply; and
- subsection 307C(5B) cannot apply (even if the circumstances of the breach would satisfy the requirements for that defence to apply); and, consequently,
- the auditor would be required to give a declaration under subsection 307C(3) in respect of the APES 110 Breach.

We believe that this is an anomalous outcome that is not consistent with the intention of the legislature (which followed from the policy of ASIC at that time in class order 05/910) that an auditor should not be required to declare inadvertent breaches of auditor independence requirements that occur in day-to-day practice and are quickly addressed once the auditor became aware of the breach.

Suggested amendment to 290.108

Given the above, we detail below in red a suggested amendment to 290.108 (as 290.108.1) of the Code in order to address the above:

APES 110 290.108

If other partners in the Office in which the Engagement Partner practices in connection with the Audit Engagement, or their Immediate Family members, hold a Direct Financial Interest or a material Indirect Financial Interest in that Audit Client, the self-interest threat created would be so significant that no safeguards could reduce the threat to an Acceptable Level. Therefore, neither such partners nor their Immediate Family members shall hold any such Financial Interests in such an Audit Client.

APES 110 290.108.1

An inadvertent violation of 290.108 is not considered to be a contravention of the Code for the purposes of section 307C of the Corporations Act 2001, provided:

- *the violation is trivial and inconsequential;*
- *the Firm has appropriate quality control policies and procedures in place, equivalent to those required by APES 320 Quality Control for Firms, to maintain Independence; and*



- *once discovered, the violation is corrected promptly and any necessary safeguards are applied to eliminate any threat or reduce it to an Acceptable Level.*

The inclusion of the above Australian text in red:

- does not affect the compliance of APES 110 with the IESBA Code, as all breaches still require reporting to 'Those Charged With Governance' under para 290.46;
- aligns with the reporting exemption approach already included in the Corporations Act, whereby contraventions of the specific independence requirements of the Corporations Act do not require inclusion in the section 307C declaration, as long as reasonable steps are taken to address the circumstance that has given rise to the contravention, and the audit partner considers that the Firm has a quality control system that provides reasonable assurance (taking into account the size and nature of the audit practice of the audit firm) that the audit firm and its employees complied with the relevant requirements of the Corporations Act; and
- removes the need for ASIC to spend its time reviewing and providing relief (now under section 340 of the Corporations Act) from disclosure for this type of breach.

Should you wish to discuss any aspect of this KPMG submission, please contact me on 03 9288 5790 or Andrew Bryant, KPMG's Head of Ethics and Independence, on 03 9288 6036.

Yours faithfully

Mark Jones AM
Ethics and Independence Partner