CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

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Dear Mr White

The appointment, resignation and removal of auditors

Chartered Secretaries Australia (CSA) is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. We represent over 8,000 governance professionals working in public and private companies, all of whom, due to their involvement in corporate administration and compliance, have a thorough working knowledge of the *Corporations Act*, and all of whom liaise with the Australian Securities and Investments Commission (ASIC) regularly in the course of their work.

CSA members have identified a variety of issues, at both the process and policy levels, in relation to the appointment, resignation and removal of auditors. In summary, the process for the appointment, resignation and removal of the auditor is cumbersome. Some areas of difficulty relate to the efficiency of the process, while others reside in the Corporations Act, which would be a matter for legislative amendment. Below we set out these issues, noting which are the process issues and which the policy issues.

CSA looks to the Australian Securities and Investments Commission (ASIC) to effect reform that would ameliorate the process difficulties currently being experienced. CSA will advocate for legislative reform where appropriate, but seeks ASIC feedback on the policy issues as raised in the first instance.

1 Process issues

a) Form 315

The mechanism for notifying the appointment or cessation of an auditor does not currently operate efficiently and effectively.

For public companies, there is no requirement to advise ASIC of the name of a new auditor at the time of appointment. This information is advised to ASIC on Form 388, Copy of Financial Statements and Reports, which is lodged together with the annual report. However, public listed

companies have relief whereby accounts lodged with Australian Securities Exchange (ASX) do not also need to be lodged with ASIC with Form 388. CSA notes that this relief, while welcome, can create problems. For example, when an auditor seeks permission from ASIC to resign, ASIC has been known to refuse permission because it does not have that auditor noted on its records. This arises as ASIC does not insist that a listed public company lodge a Form 388 each year.

CSA notes that the inefficiency of the process in relation to the absence of a form to notify ASIC of the appointment of an auditor can also create difficulties in the following situations:

- when incorporating a public company or converting from a private company to a public company, and
- when a small proprietary company becomes a large proprietary company.

Furthermore, directors of a public company must within one month of registration appoint an auditor who holds office until the company's first annual general meeting (AGM) (s 327A). Under s 327B, a public company must appoint an auditor at its first AGM. This raises a policy issue which we canvass in the next section ('Policy issues'). At that first AGM, it is the right of shareholders to appoint the auditor. It may be that the shareholders appoint a different auditor than was originally appointed by the directors. There is no provision on Form 315 to show that the auditor is not resigning (which requires ASIC approval) but ceased to hold office at the first AGM. Thus there is no provision on the form to allow for the process as set out in the Corporations Act.

CSA recommends that Form 315 could be a multi-faceted form, containing provision for:

- companies to notify the name of the auditor at the time of appointment (appointment of auditor). Currently, Form 315 provides for the cessation of the auditor only
- the cessation of the auditor at the first AGM, if that auditor is not reappointed by the shareholders.The name of the replacement auditor could also be advised
- the resignation of the auditor following the conversion of a public company to a proprietary company
- the resignation of the auditor following a large proprietary company becoming a small proprietary company.

CSA notes that the forms for registered schemes already provide for notification of both the appointment and cessation of the auditor (FS06 and FS08) and the logic behind this form would be expected to apply to public and large proprietary companies.

Guide to Form 315
CSA recommends that the Guide to Form 315 contain information reminding companies of the obligation to appoint an auditor:

- within one month when converting from a private company to a public company
- when a small proprietary company becomes a large proprietary company.

CSA recommends that this information be contained in the Guide to Form 315 as, in the circumstances listed, the statutory obligations concerning auditors are different and advice to companies concerning these obligations will result in better compliance.

CSA notes that the current Form 315 references a number of sections from the Corporations Act that have been repealed — ss 327(4), 327(15), 324(1) and 319(5)(a).

CSA recommends that the Guide to Form 315 contain the correct references.

CSA also recommends that the references on the Guide to Form 315 include a reference to s 327H (see our comments below under 'Need to provide for different requirements when takeovers occur and the auditor is the same for both the acquiring and target company').

Penalties attached to current difficulties with Form 315
CSA members have found that when the shareholders do not reappoint the auditor originally appointed by the directors of a public company at the first AGM, ASIC has been known to penalise the company for not notifying ASIC of the auditor's resignation. CSA notes that members are unable to advise ASIC that the auditor has resigned in such circumstances, as it is not a resignation. It is the shareholders' right to appoint an auditor that is being exercised. CSA notes that its members cannot advise ASIC of a resignation that did not occur.

CSA notes that this difficulty would cease if Form 315 provided for notification of cessation of auditor at the first AGM, if shareholders appoint a different auditor.

b) Application and consent to resign

Form 342
CSA notes that when an auditor wishes to resign, ASIC consent is required. CSA supports this requirement, which is to ensure that the auditor is resigning for appropriate reasons and is not being dismissed or forced to resign. The policy objective, which CSA supports, is to protect shareholders and ensure that the directors are not applying pressure on the auditor to resign.

Form 342 is used when seeking permission to resign as auditor.

However, CSA notes that, due to the reasons noted above, ASIC may not necessarily grant consent for the auditor to resign, even when it is an appropriate resignation, on the basis that ASIC did not approve the appointment.

The recommendations relating to Form 315 noted above would ameliorate this issue.

Notification of company of consent to resign
CSA notes that ASIC has a statutory obligation (s 329(6)) to send dual notices of consent to resign to both the auditor and the company.

However, CSA notes that ASIC is inconsistent in meeting this obligation. While ASIC always notifies the auditor of its consent to resign, it frequently fails to also notify the company that consent has been provided.

CSA recommends that ASIC institute internal procedures to ensure that it always notifies the company at the same time that it notifies the auditor of its consent to the auditor to resign.

c) Application to resign

CSA notes that companies do not know whether ASIC has received an application for an auditor to resign. CSA supports the maintenance of confidentiality in relation to applications to resign, and is fully committed to both the application form and any reasons put forward for seeking permission to resign remaining confidential.

However, ***CSA recommends*** that, unless ASIC is investigating improper conduct or fraud, it notify the company that an application to resign has been received. In the majority of instances, the company knows that the auditor is applying to resign, but, if the auditor forgets to apply to

resign, the company has no way of knowing that the application has not been submitted, nor of knowing when and if ASIC has received that application.

d) ASIC Guide 26

Currently, ASIC Guide 26 specifically excludes the result of an audit tender from its list of exceptional circumstances. This creates very practical difficulties for companies, as the timing of the tender process frequently does not accord with the timing of the AGM.

In reality, this results in companies being forced to either call a general meeting (at cost to shareholders) to remove the existing auditor and appoint the new auditor that has been successful in the tender process, or retain the existing auditor that has not been successful in the tender process until such time as the next AGM is held. In the latter case, this may result in the existing auditor knowing that in, say, April, a new auditor will be appointed at the AGM in, say, November, but the auditor will still have to complete the June audit. It is arguable whether this situation will result in the best audit outcome, despite the professionalism of registered auditors. It is simply not realistic to assume that companies will always be able to undertake the tender process just prior to the AGM, and be able to obtain ASIC consent prior to the AGM.

From a risk mitigation point of view, the running of a tender process in the lead-up to an AGM, which also coincides with the preparation of year-end accounts and the busiest time of the year in an auditor's work program, is not preferable, particularly where the outgoing auditor is required to be informed of the outcome of the tender prior to delivering their report. While auditors will no doubt insist that such a situation would not impact on their ability to continue to perform their services professionally and impartially, it would be far more preferable (and prudent) if companies could conduct external audit tenders well outside the timing for key audit deliverables and not be required to call a second general meeting (at cost to shareholders) in any one year to obtain member approval.

CSA recommends that:

1. ASIC provide consent for the existing auditor to resign where that auditor has been unsuccessful in a tender process.
2. In these tender cases, the directors be authorised to appoint the new auditor until the next AGM, at which time the shareholders will be requested to approve (or not) the appointment of the new auditor. (This is similar to the requirements for a public company on registration under s 327A.)

2 Policy issues

a) Need for consistent regime

CSA members note that listed public companies and unlisted public companies have statutory requirements for member appointment of the auditor at the general meeting, whereas wholly-owned subsidiaries and registered schemes do not need to hold an AGM. The issues surrounding the appointment, removal and resignation of auditors therefore become more complex and confusing when these differences are taken into account.

Compliance plans

CSA notes that currently there are no forms for a responsible entity to notify ASIC of the appointment or resignation of the auditor of a compliance plan. There is also no form for an auditor of a compliance plan to apply to resign.

CSA recommends that a consistent regime be implemented to provide for the appointment, resignation and application to resign of the auditor. This regime should apply to:

- companies
- AFS licensees

- registered schemes
- compliance plans.

b) Member appointment of auditor in one-member public companies

Directors of a public company must within one month of registration appoint an auditor who holds office until the company's first annual general meeting (AGM) (s 327A)). Under s 327B, a public company must appoint an auditor at its first AGM. However, when the public company is a one-member company, s 250N(4) states that a public company that has only one member does not need to hold an AGM. This raises uncertainty as to the requirement under s 327B.

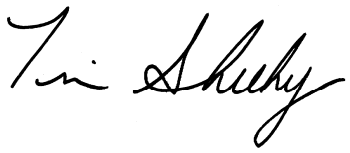
CSA recommends that the legislation clarify that s 327B override any requirement under s 250N where the public company is a one-member company. CSA believes that the member or members should always appoint the auditor as a matter of principle

c) Need to provide for different requirements when takeovers occur and the auditor is the same for both the acquiring and target company

CSA notes that, when a takeover occurs, the current default position is that the auditor of the company that begins to be controlled by another company must retire at the next AGM (s 327H(a)). The target company must then call for nominations and appoint an auditor at the next AGM. Where the auditor of the target company and the acquiring company is the same auditor, CSA cannot point to any practical or public benefit being achieved by requiring auditors to retire and target companies to reappoint the auditor where that auditor is the auditor of the acquiring company.

CSA recommends that the default position should be that, unless the acquiring company gives notice to the auditor of the target company to step down, the target company should not be required to ask its auditor to retire and then reappoint them at the next AGM.

Yours sincerely



Tim Sheehy
CHIEF EXECUTIVE

cc Jennifer O'Donnell, Executive Director Compliance & NSW Regional Commissioner, Australian Securities & Investment Commission