



**ASIC**

Australian Securities & Investments Commission

CONSULTATION PAPER 72

# Auditor rotation

April 2006

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## **Your comments**

**You are invited to comment on the proposals and issues for consideration in this paper, including the explanation sections.**

**We will not treat your submission as confidential unless you specifically request that we treat the whole or part of your submission as confidential. If your submission includes financial information, we will consider a request from you that we treat that section of your submission as confidential.**

**Comments are due by 26 May 2006 and should be sent to:**

**Ms Joanna Bird  
Assistant Director  
Regulatory Policy  
Australian Securities and Investments Commission  
GPO Box 9827  
Sydney NSW 2001  
facsimile 02 9911 2316  
email: [policy.submissions@asic.gov.au](mailto:policy.submissions@asic.gov.au)**

**You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.**

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**Important Note:** The proposals and explanations in this paper do not constitute legal advice. The proposals, explanations and examples in this paper are at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

This paper is based on the Corporations Act as at 10 April 2006. We do not anticipate any changes to the Corporations Act that will affect our proposals. However, if there are relevant changes to the Corporations Act before we publish our final policy, we will take them into account.

# What this policy proposal is about

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**1** This policy proposal paper seeks your views on how we should use the relief power in s342A of the *Corporations Act 2001* (Corporations Act) to modify the auditor rotation requirements.

**2** Under s324DA of the Corporations Act, the auditor of a listed company or listed registered managed investment scheme (listed scheme) must stop playing a significant role in the audit of the company or scheme after a certain period of time (rotation requirements). This is referred to as ‘auditor rotation’.

Note: In this paper we refer to a listed company or a listed scheme as the ‘audit client’.

**3** This policy proposal paper covers:

- (a) our general approach to relief (**Section A**);
- (b) how we will apply the criteria for relief (**Section B**); and
- (c) what we expect to see in an application for relief (**Section C**).

**4** We have also included a ‘Background’ section at the beginning of this paper, which gives an overview of the rotation requirements. Schedule 1 provides an overview of the audit market and Schedule 2 gives some examples of how the rotation requirements might apply in practice.

## Making a submission

**5** This paper will help us develop our policy on the rotation requirements. The proposals in this paper are only an indication of the approach we may take and are not our final policy. We are seeking:

- (a) your comments in response to the specific questions in this paper; and
- (b) any other comments you have about the rotation requirements.

**6** We are also seeking general information from you about how auditor rotation will affect your practice as an auditor. We are particularly interested in the views of:

- (a) sole practitioners;
- (b) smaller audit firms and authorised audit companies (AACs);

- (c) auditors, audit firms and AACs who practise in rural or remote areas; and
- (d) audit clients.

7 In particular, we would like to understand what financial impact auditor rotation may have on individual auditors and smaller audit firms (e.g. what impact there might be on audit fees) and on audit clients (e.g. whether there might be increased audit fees or costs associated with changing to a new auditor). See the ‘Regulatory and financial impact’ section of this paper.

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# Background

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## What are the rotation requirements?

**1** Auditor rotation is part of the auditor independence requirements introduced into Part 2M.4 of the Corporations Act by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9 Act).

**2** There are two auditor rotation obligations:

- (a) the 'time-out rule' in s324DA(1); and
- (b) the '5/7 rule' in s324DA(2).

Note: In this paper, we refer to these obligations as the 'rotation requirements'.

**3** The time-out rule provides that an individual who has played a significant role in the audit of a particular audit client for 5 successive financial years is not eligible to continue to play a significant role unless the individual has not played such a role for at least 2 successive financial years. The 5/7 rule provides that an individual may not play a significant role in the audit of a particular audit client for more than 5 out of 7 successive financial years.

## Who must rotate?

**4** The rotation requirements only apply to:

- (a) audits of listed companies and listed schemes; and
- (b) individuals who play a significant role in the audit of a listed company or listed scheme.

Note: See Section A (Explanation paragraph 12) for the definition of 'plays a significant role'.

**5** If an individual auditor has been appointed as the auditor of the listed company or listed scheme, that individual and the review auditor (if any) must rotate. If an audit firm or authorised audit company (AAC) has been appointed as the auditor of the company or scheme, only the lead auditor and the review auditor (if any) must rotate. The rotation requirements do not require that the audit firm or AAC rotate.

Note 1: See the 'Key terms' for definitions of 'lead auditor' and 'review auditor'.

Note 2: It is not mandatory to appoint a review auditor.

## What is the effect of rotation?

**6** An auditor of a listed company or listed scheme must be eligible to play a significant role in the audit of that particular audit client for the relevant financial year. The effect of the rotation requirements is to define who is, and who is not, eligible to play a significant role in the audit of a listed company or listed scheme.

**7** It is clear that auditors who operate as sole practitioners will be directly affected by the rotation requirements (i.e. they will not be able to continue as the auditor of a listed audit client after the period specified in s324DA).

**8** Smaller audit firms and AACs are also likely to be significantly affected, as they may not have enough auditors who are eligible to undertake the audit of a listed audit client to comply with the rotation requirements. Therefore, smaller audit firms and AACs might lose listed audit clients, at least temporarily, because of the rotation requirements.

**9** Larger firms and AACs are unlikely to be significantly affected, as they will have enough eligible auditors to comply with the rotation requirements.

**10** Some examples of how the rotation requirements will apply in particular situations are in **Schedule 2**.

## What happens if an auditor fails to rotate?

**11** Unlike the other auditor independence obligations in Part 2M.4, contravention of the rotation requirements does not lead to the automatic termination of the auditor's appointment.

**12** If an auditor (including an auditor acting on behalf of an audit firm or AAC) plays a significant role in the audit of a listed company or listed scheme when that auditor is not eligible to do so, that auditor has contravened s324DB. If the auditor is acting on behalf of an audit firm or AAC then in some circumstances, members of the auditor's firm (under s324DC), or the auditor's AAC and its directors (under s324DD), will be liable also for a criminal offence.

Note 1: The members of the firm or directors of the AAC may be able to rely on a quality control system defence: see s324DC(4) and 324DD(5).

Note 2: Throughout this paper the term 'member' has been used. A member might more commonly be known as a *partner* of an audit firm.

**13** The validity of an audit will not be affected if an ineligible auditor plays a significant role in the audit because, as stated in paragraph 11

above, contravention of the rotation requirements does not lead to the automatic termination of that auditor's appointment.

Note: The other auditor independence requirements (see Div 3 of Pt 2M.4) provide that an auditor ceases to be the auditor of a company where a conflict of interest situation arises, or one of the specific independence requirements has been breached, and the conflict or breach has not been remedied within the period provided in s327B (i.e. 21 days). Similar provisions apply to the auditor of a listed scheme: see s331AAA.

## How are we notified of contraventions?

**14** An auditor who has conducted an audit of the financial report or an audit or review of any half-year financial report must make a written declaration to the directors of the audit client that includes whether, to the best of the individual auditor's knowledge and belief, there have been any contraventions of the auditor independence requirements. The definition of 'auditor independence requirements' in s9 expressly includes Div 5 of Pt 2M.4 (i.e. the rotation requirements).

**15** In addition, we think that contraventions of the rotation requirements are significant contraventions that must be reported to us under s311.

Note 1: For more information about s311, see Section A (policy proposal A9 and Explanation paragraphs 17-18).

Note 2: See also Practice Note 34 *Auditors' obligations: reporting to ASIC* [PN 34].

## What is ASIC's relief power?

**16** We have limited power under s342A to modify the rotation requirements. We call this our 'specific relief power'. It allows us to:

- (a) declare that the time-out rule applies to the auditor as if the references in s324DA(1) to 5 successive financial years were references to 6 or 7 successive financial years (s342A(1)); or
- (b) declare that the 5/7 rule applies to the auditor as if the references in s324DA(2) to 5 out of 7 successive financial years were references to 6 out of 7 successive financial years.

**17** Our specific relief power does not give us power to exempt a person from the rotation requirements: see **Section A**.

Note: The situation is different in the US, where the Securities and Exchange Commission (SEC) has power to exempt accounting firms from the audit partner rotation requirements in the Sarbanes-Oxley Act of 2002. The SEC has exempted accounting firms with fewer than 5 audit clients and fewer than 10 partners from the requirement that the lead auditor rotate after 5 years (see Section 210.2-01(c)(6) of

Regulation S-X). The 'time-out' period in the US is 5 years compared with 2 years in Australia.

**18** Under s342A(6), we may only use our specific relief power if we are satisfied that, without modification, the rotation requirements would impose an unreasonable burden on:

- (a) the auditor;
- (b) the audit firm or AAC on whose behalf the auditor acts in relation to the audit; or
- (c) the audit client.

See **Section B**.

**19** We may only use our specific relief power in response to an application for relief made by the auditor or the audit firm or AAC on whose behalf the auditor acts: see **Section C**.

**20** In addition to our specific relief power, we might consider exercising our general powers under s340 to make a specific exemption order or under s341 to make a class order: see **Section A**.



# Policy proposals

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In this paper, we have three groups of policy proposals. For each group, we have set out our proposals and identified issues we would like you to comment on. When necessary, we have also included some explanations of our proposals.

**Special note:** There may be other issues that you consider important. We are keen to hear from you on our general approach and any other issues you consider important, as well as your answers to our specific questions.

# A Our general approach to relief

Policy proposal	Your feedback
<p><b>What are the underlying principles?</b></p> <p><b>A1</b> When considering an application for relief from the rotation requirements, we will seek to balance:</p> <ul style="list-style-type: none"> <li>(a) the interests of investors in being able to make an informed choice about how to invest their money by reference to financial reports that are reliable and credible;</li> <li>(b) the need for financial reports to be, and to be seen to be, independently scrutinized in order to promote the integrity of the market as a whole;</li> <li>(c) the desire to maintain and improve audit quality by ensuring that appropriately skilled and experienced auditors are available to conduct the audit of a listed entity; and</li> <li>(d) the desire to minimise the commercial impact of the auditor rotation requirements on auditors and audit clients.</li> </ul>	<p><b>A1Q1</b> Do you agree with this approach? If not, why not?</p> <p><b>A1Q2</b> What other general factors (if any) do you think we should take into account?</p>
<p><b>What power do we have to give relief?</b></p> <p><b>A2</b> We propose to use our specific relief power under s342A in preference to making an exemption order under s340 or a class order under s341. We will generally only give relief from the rotation requirements under s340 or 341:</p> <ul style="list-style-type: none"> <li>(a) in exceptional or special circumstances; or</li> <li>(b) in the case of s340, where for technical reasons we cannot use s342A;</li> </ul> <p style="margin-left: 40px;">Note: We cannot impose conditions under s342A.</p> <ul style="list-style-type: none"> <li>(c) in the case of s341, where we are satisfied</li> </ul>	<p><b>A2Q1</b> Do you agree with this approach? If not, why not?</p> <p><b>A2Q2</b> In what circumstances (if any) do you think it would be appropriate to impose conditions on relief? For example, in what circumstances (if any) would it be appropriate to impose a condition requiring the appointment of a review auditor?</p>

that there is a clear case for class order relief.

Note: We cannot make a class order under s342A.

**A3** We will apply Policy Statement 43 *Accounts and audit relief* [PS 43] to applications for relief under s340 or 341.

## Who must rotate?

**A4** The rotation requirements apply to individual auditors, including the lead auditor or review auditor (if any).

Note: See Explanation paragraphs 11–12.

**A5** When an audit firm or AAC has been appointed as auditor, the lead auditor does not have to be a member of the audit firm or a director of the AAC. We consider that any employee of the audit firm or AAC who is a registered company auditor (RCA) may act as the lead auditor.

**A6** The review auditor does not have to be a member of the audit firm or a director of the AAC. We consider that:

- (a) any employee of the individual auditor, audit firm or AAC who is an RCA; or
- (b) any person who is an RCA and who has been specially engaged by the individual auditor, audit firm or AAC to review the conduct of an audit,

may act as the review auditor.

Note 1: It is not mandatory to appoint a review auditor.

Note 2: A review auditor may be appointed by an individual auditor, an audit firm or AAC.

**A5Q1** Do you agree with this approach? If not, why not?

**A5Q2** How many RCAs does your audit firm or AAC have in total (ie. members of your firm or directors of your AAC, and employees)?

**A5Q3** Do you ever use an employee, rather than a member or director, as the lead auditor on the audit of a listed client? If so, please give details.

**A6Q1** Do you generally appoint someone to review the conduct of the audit of a listed audit client? If so, please give details (e.g. In what circumstances? How often? How formal is the appointment?).

**A6Q2** In particular, if you are a sole practitioner, have you ever appointed an auditor to review the conduct by you of the audit of a listed audit client?

**A6Q3** If you answered yes to A6Q1 or A6Q2, does the definition of 'review auditor' accurately describe what the person conducting the review does?

## When must an auditor rotate?

**A7** You should not accept appointment as the auditor of a listed company or listed scheme or act in the role of lead auditor or review auditor if you are not eligible to play a significant role in the audit of that audit client. It is your responsibility to monitor your own eligibility.

**A8** However, if you have consented to being appointed as the auditor of a listed audit client for a financial year and have subsequently become aware that you are not eligible to play a significant role in the audit during that financial year, you must resign under s329(5) or 331AC(2). The subsequent vacancy may be filled as if it were a 'casual vacancy' under s327D or 331AAB.

Note 1: See Policy Statement 26 *Resignation of auditors* [PS 26].

Note 2: Resignation of the audit firm or AAC as the auditor of the listed company or listed scheme will only be necessary if no RCA at the firm or AAC is eligible to act as the lead auditor or review auditor.

**A6Q4** In what circumstances (if any) would you appoint an external RCA (i.e. someone other than a member, director or employee) as the review auditor? What practical problems might arise if your review auditor was external?

**A6Q5** In what circumstances (if any) would you appoint someone as an 'engagement quality control reviewer' under Auditing and Assurance Standard AUS 206 *Quality Control for Audits of a Historical Financial Information* (AUS 206) instead of, or in addition to, appointing a review auditor? Would you ever appoint someone who is not an RCA to this role?

**A8Q1** Do you agree with this approach? If not, why not?

## Notifying us of contraventions

**A9** We consider that a contravention of the rotation requirements is a significant contravention of the Corporations Act that must be reported to us under s311.

Note: See Practice Note 34 *Auditors' obligations: reporting to ASIC* [PN 34].

**A9Q1** Do you agree with this approach? If not, why not?

## Explanation

**1** The stated purpose of the rotation requirements is to promote independence. They ensure that auditors do not remain with audit clients for significant periods that may result in inappropriate relationships developing between the auditor and audit client, compromising the independence of the audit function.

**2** The purpose of auditor independence is to enhance the reliability and credibility of financial reports. However, in some situations there may be tension between the rotation requirements and the desire to maintain audit quality. In some cases, auditor rotation may adversely impact on audit quality if future audits are conducted by an auditor with less experience relevant to the audit of a particular audit client.

**3** In addition, we recognise that, in some circumstances, auditor rotation will have a commercial impact on auditors, audit firms, AACs and their audit clients.

**4** In light of this, when considering an application for relief from the rotation requirements we will seek to balance the policy objectives set out in policy proposal A1.

### What power do we have to give relief?

**5** It is clear from the background material for the auditor independence requirements that Parliament intended us to consider using our specific relief power under s342A to grant relief for smaller audit firms and those operating in rural and remote areas where compliance with the law (i.e. the obligation for the auditor to rotate) may impose an unreasonable burden. In some circumstances, the auditor rotation requirements may also impose an unreasonable burden on an audit client.

**6** Our specific relief power is limited. We may only modify s324DA in one of two ways:

- (a) by extending the period before the time-out rule will apply (by not more than 2 successive financial years); or vvv
- (b) extending the period before the 5/7 rule applies (by allowing an auditor to play a significant role in the audit for not more than 1 additional financial year).

**7** Under s342A, we do not have the power to provide an exemption from the rotation requirements. We also do not have power under s342A to impose conditions on any relief that we might give. Despite these limitations, we will generally not consider granting relief from the

rotation requirements using our general relief powers in either s340 or 341. We think this is consistent with Parliament's intention.

**8** However, we might give relief under s340 if we consider that the technical limitations in s342A unduly restrict our ability to customise the form of relief (e.g. we cannot impose conditions on relief given under s342A; we may do so under s340). For example, we may consider that relief is appropriate only on condition that a review auditor is appointed. The rotation requirements aim to ensure auditor independence. Appointment of a review auditor as a condition of relief might be an option to promote auditor independence.

**9** We might consider granting relief under s341 if we are convinced that a class order, rather than an individual instrument of relief, is more appropriate in the circumstances (e.g. if the relief sought would provide a solution to an industry-wide problem).

**10** In either case, we will only grant relief that is consistent with the policy objectives of auditor independence and where the applicant has satisfied us that, without relief, the rotation requirements will impose an unreasonable burden on the auditor or its audit client.

## Who must rotate?

**11** If an individual auditor has been appointed as the auditor of a listed company or listed scheme, that person and the review auditor (if any) must comply with s324DA. If an audit firm or AAC has been appointed as the auditor of a listed company or listed scheme, then the lead auditor and review auditor (if any) must comply with s324DA. Both the lead auditor and review auditor must be RCAs.

**12** The rotation requirements apply only to an auditor who 'plays a significant role' in the audit of a listed client. Your eligibility will depend on whether you have played a significant role in the audit of a particular listed audit client in previous financial years. Playing a significant role in an audit is defined in s9 of the Corporations Act as follows:

'a person *plays a significant role* in the audit of a company or a registered scheme for a financial year if:

- (a) the person is appointed as an individual auditor of the company or scheme for that financial year and:
  - (i) acts as an auditor for the company or scheme for that financial year; or
  - (ii) prepares an audit report for the company or the scheme in relation to a financial report of the company or

scheme for that financial year or for a half-year falling within that financial year; or

- (b) a firm or company is appointed as an auditor of the company or scheme for that financial year and the person:
  - (i) is a registered company auditor; and
  - (ii) acts, on behalf of the firm or company, as a lead auditor, or review auditor, in relation to an audit of the company or scheme for that financial year or for a half-year falling within that financial year.’

Note 1: If you are ineligible to act as the lead auditor you cannot simply swap roles with the review auditor (or the other way around).

Note 2: See Schedule 2 for examples of how the rotation requirements will apply

**13** We consider that a person acts as an auditor in relation to an audit of a listed company or listed scheme from the time that person ‘engages in audit activity’ in relation to the audit client.

Note: ‘Engage in audit activity’ is defined in s9 of the Corporations Act.

**14** The Corporations Act does not require you to appoint a review auditor. However, Auditing and Assurance Standard AUS 206 *Quality Control for Audits of Historical Financial Information* (June 2004) provides that an ‘engagement quality control reviewer’ should be appointed to review the audit of a financial report of a listed entity. ‘Engagement quality control reviewer’ is defined in AUS 206.05 as:

‘[A] partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the auditor’s report is issued, the significant judgements the engagement team made and the conclusions they reached in formulating the auditor’s report.’

**15** While the definition of ‘engagement quality control reviewer’ in AUS 206 is more comprehensive than the definition of ‘review auditor’ in s9 of the Corporations Act, it is clear that, to some extent at least, the activity undertaken by the ‘engagement quality control reviewer’ will overlap with that of a ‘review auditor’. However, the ‘engagement quality control reviewer’ appointed under AUS 206 does not have to be an RCA. If the person appointed under AUS 206 is not an RCA, they cannot be the ‘review auditor’ under the Corporations Act and, therefore, do not have to rotate.



## When must an auditor rotate?

**16** An auditor who is not eligible to play a significant role in an audit for a particular financial year should not consent to act as the auditor of a listed company or listed scheme for that financial year. It is the auditor's responsibility to monitor their own eligibility and ensure they are eligible before consenting to their appointment or engaging in audit activity. It is also the auditor's responsibility to advise their audit client if they are ineligible to be reappointed as the auditor.

Note: The contravention provisions in s324DC and 324DD expressly refer to consenting to act as the auditor as an element of the offence.

## Notifying us of contraventions

**17** Section 311 of the Corporations Act requires an auditor conducting an audit to report to us if the auditor is aware of circumstances that the auditor has reasonable grounds to suspect amount to a significant contravention of the Corporations Act. There is nothing in s311 that limits the reporting obligation to contraventions of the Corporations Act by the audit client. We consider that an auditor must notify us of the auditor's own contraventions of the Corporations Act, including any contraventions of the time-out rule or the 5/7 rule.

**18** We consider that a contravention of the rotation requirements of the Corporations Act is significant. The definition of 'significant' in s311(4) expressly directs the auditor to consider:

- '... the effect that the contravention has, or may have, on:
- (i) the overall financial position of the company, registered scheme or disclosing entity; or
  - (ii) the adequacy of the information available about the overall financial position of the company, registered scheme or disclosing entity ...'.

Note: See Practice Note 34 *Auditors' obligations: reporting to ASIC* [PN 34].

## B What are the relief criteria?

Policy proposal	Your feedback
<p><b>B1</b> We can only grant relief if we are satisfied that compliance with the rotation requirements will impose an unreasonable burden on either:</p> <ul style="list-style-type: none"> <li>(a) the audit client; or</li> <li>(b) the auditor (i.e. an RCA, audit firm or AAC).</li> </ul> <p>We may be more likely to grant relief if you can identify a burden on both yourself as auditor and your audit client.</p> <p><b>When is a burden unreasonable?</b></p> <p><b>B2</b> Before we can grant relief we need to be satisfied not only that there is a burden, but also that the burden is unreasonable. In [PS 43.23], we say that a requirement of the law may be burdensome in one of two ways:</p> <ul style="list-style-type: none"> <li>(a) there may be a burden associated with attaining compliance with the requirement; or</li> <li>(b) a burden may result from having complied with the requirement.</li> </ul> <p>We will interpret s342A in the same way.</p> <p><b>B3</b> We consider that an unreasonable burden is one that:</p> <ul style="list-style-type: none"> <li>(a) goes beyond what is equitable; or</li> <li>(b) is excessive.</li> </ul> <p><b>B4</b> In determining whether a burden is unreasonable, we will look at the nature and extent of the detriment (if any) that will result from compliance (including the administrative costs of compliance). We will try to balance this against the benefits of compliance to users of the financial reports and to the market as a whole.</p>	<p><b>B1Q1</b> In what circumstances (if any) would a burden on the auditor alone (i.e. auditor rotation would not adversely affect the audit client) be sufficient reason for us to grant relief?</p> <p><b>B2Q1</b> Do you agree with this approach? If not, why not?</p> <p><b>B4Q1</b> Do you agree with this approach? If not, why not?</p> <p><b>B4Q2</b> Have you considered what financial impact the rotation requirements will have on you or your audit firm or AAC? If so, how have you quantified this impact?</p> <p><b>B4Q3</b> Have you considered what</p>

## Unreasonable burden on the audit client

**B5** We consider that the rotation requirements will impose an unreasonable burden on the audit client when, because of the nature of the audit client, application of the rotation requirements would mean that the audit client cannot access an alternative suitable auditor.

**B6** An alternative suitable auditor is an auditor who:

- (a) can produce an audit report for the listed company or listed scheme of the desired quality: see policy proposal B8;
- (b) is available to conduct the audit of the listed company or listed scheme: see policy proposal B9; and
- (c) is legally permitted to conduct the audit of the listed company or listed scheme: see policy proposal B10.

**B7** We consider that there is a competitive market for RCAs such that an alternative suitable auditor will be available in most cases. However, in some limited circumstances it may be difficult to find an alternative suitable auditor.

additional costs might arise for your audit client from the rotation requirements? For example, are you able to quantify the cost of changing to a new auditor?

**B4Q4** What benefits do you consider will result from auditor rotation? Do you think it is possible to quantify those benefits?

**Please note that you may ask us to treat any financial information that you give us as confidential.**

**B6Q1** Are there any other relevant criteria? If so, what?

**B7Q1** Do you agree? If not, why not?

### ***Audit report of the required quality***

**B8** In some circumstances:

- (a) the industry in which the audit client operates;
- (b) the complexity of the audit; or
- (c) the structure of the corporate group of which the audit client is a member,

may mean that there is no alternative suitable auditor who can produce an audit report of the required quality.

### ***Availability of other registered company auditors***

**B9** We will assess the availability of other auditors in two ways:

- (a) Where an audit firm or AAC has been appointed as auditor, are there other auditors within the same audit firm or AAC that can undertake the audit?
- (b) If an individual has been appointed as the auditor or there are no auditors that satisfy paragraph (a), are there other auditors in the general pool of all Australian RCAs that can provide satisfactory audit services?

However, we think that generally lack of an available eligible auditor within the same audit firm or AAC will not be enough to create an unreasonable burden for an audit client.

### ***Special audit requirements***

**B10** We will grant relief where special audit requirements apply to the audit of the listed company or listed scheme (e.g. the audit must be conducted by an auditor approved by a body such as APRA) and there is no other auditor who can comply with these requirements.

**B8Q1** In what other circumstances (if any) do you consider that there may be no alternative suitable auditor who can produce an audit report of the desired quality?

**B8Q2** Are we correct in assuming that some audits require specialist knowledge and skills or can all RCAs audit all listed companies or listed schemes?

**B9Q1** In what circumstances (if any) should we grant relief when there is no other available auditor within the same audit firm or AAC, even though there are other eligible auditors in the broader audit market?

**B10Q1** Do you agree with this approach? If not, why not?

**B10Q2** Are you aware of special audit requirements other than those referred to in paragraph 13 of the Explanation? If so, please give details.

### ***What is not an unreasonable burden on the audit client?***

**B11** We do not consider that the loss of the audit client's preferred auditor, of itself, imposes an unreasonable burden on the audit client.

**B12** We do not consider that an increase in the audit costs of the audit client, of itself, imposes an unreasonable burden on the audit client.

### **Unreasonable burden on the auditor**

**B13** Generally, we are more likely to be convinced that the rotation requirements impose an unreasonable burden on:

- (a) sole practitioners;
- (b) smaller audit firms or AACs; and
- (c) auditors practising in rural or remote areas, than larger firms or AACs or firms or AACs practising in urban areas.

**B14** We consider that in some situations the rotation requirements may impose an unreasonable burden on any audit firm or AAC, regardless of its size or location. For example, an unexpected event, such as the death or sudden illness of the lead auditor, in circumstances where the only other available auditor in the firm or AAC is ineligible to act because of the auditor rotation requirements, might be a compelling reason to give relief.

**B11Q1** Do you agree with this approach? If not, why not?

**B12Q1** Are there any circumstances in which you consider that an increase in audit costs will impose an unreasonable burden on an audit client? If so, please give details.

**B13Q1** Do you agree with this approach? If not, why not?

**B14Q1** In what other circumstances do you think that an unreasonable burden would be imposed on a larger urban firm or AAC? Please give details.

### ***Smaller audit firms or AACs***

**B15** To determine whether the rotation requirements impose an unreasonably disproportionate burden on an audit firm or an AAC because of its size, we will consider:

- (a) how many of the members of the audit firm or directors of the AAC are RCAs;
- (b) how many other RCAs are available within the audit firm or AAC (e.g. employees); and
- (c) how many listed audit clients the audit firm or AAC has.

We will take into account whether the size of your audit firm or AAC means that there are no other available auditors within your firm or AAC.

### ***Auditors in rural or remote areas***

**B16** To determine whether the rotation requirements impose an unreasonably disproportionate burden on an auditor, an audit firm or an AAC because of its location, we will consider:

- (a) the geographic location of the auditor;
- (b) the number of potential audit clients within a reasonable distance of the auditor; and
- (c) the additional costs (if any) for the auditor if it is necessary to travel further to conduct an audit.

### ***What is not an unreasonable burden on the auditor?***

**B17** We do not consider that an adverse financial impact on the auditor (e.g. loss of audit fees, loss of the audit client), of itself, imposes an unreasonable burden on the auditor.

**B15Q1** Are these the right factors for us to consider? If not, what other factors should we take into account?

**B15Q2** In what circumstances do you think that an audit firm or AAC would have no other available auditors? Please give details.

**B15Q3** Do you think that 'staggering' the rotation requirements would help? If so, please give details.

**B16Q1** Do you agree with this approach? If not, why not?

**B16Q2** Are these the right factors for us to consider? If not, what other factors should we take into account?

**B17Q1** Do you agree with this approach? If not, when do you think that an adverse financial impact on the auditor would, of itself, impose an unreasonable burden? Please give examples.

## Explanation

**1** Under s342A(6) of the Corporations Act, we cannot grant relief unless we are satisfied that compliance with the rotation requirements will impose an unreasonable burden on:

- (a) an RCA;
- (b) an audit firm or AAC on whose behalf the RCA acts; or
- (c) the audit client.

**2** You need only demonstrate that a burden has been imposed on one of the persons in (a), (b) or (c) above. However, if you can demonstrate that an unreasonable burden is imposed on your audit client in addition to yourself or your audit firm or AAC, we will take this ‘double-burden’ into account.

### When is a burden unreasonable?

**3** Section 342A(6) provides that before we can grant relief we must be satisfied that the law, without modification, would ‘impose an unreasonable burden’. The same criterion is included in s342(1)(c), which sets out the preconditions to the exercise of ASIC’s exemption powers in s340 and 341. Case law on s342 provides guidance on the meaning of unreasonable burden in s342A(6).

**4** We consider that an unreasonable burden is one that ‘... goes beyond what is based on reason or good sense, goes beyond what is equitable or is excessive’: *Mazda Australia Pty Ltd v ASC* (1992) 8 ACSR 613 at 625. In the same case, it was also held that ‘... the balance must be so far against the interests of the applicant as to be fairly described as overwhelming’.

**5** An earlier case proposes a more specific test: ‘[T]he burden is such that a serious economic detriment will result if there is compliance with the legislative requirement with little or no compensating benefit to users of the accounts.’ *Directors of Liquid Air (WA) Pty Ltd v Commissioner for Corporate Affairs* (1989) 15 ACLR 29.

**6** In deciding whether an unreasonable burden would be imposed, we must consider:

- (a) the nature of the audit client, including whether the activity in which the audit client engages is such that specialist knowledge about that activity is necessary to carry out the audit properly;
- (b) the availability of other RCAs capable of providing satisfactory audit services for the audit client; and

(c) any other matters which we consider relevant: s342A(7).

**7** We consider that the background material about the introduction of the rotation requirements makes it clear that the primary policy objective is that auditors will rotate. This view is supported by the very limited nature of our specific relief power.

## **Unreasonable burden on the audit client**

**8** The Australian market for RCAs is competitive. We consider that in most cases it will be possible to comply with the rotation requirements but find an alternative RCA capable of providing satisfactory audit services to a listed company or listed scheme. However, in limited circumstances this may not be the case and we will, therefore, consider using our specific relief power.

### ***Audit report of the required quality***

**9** The policy basis for requiring auditor rotation is that auditor independence will enhance the reliability and credibility of financial reports. However, in some situations there may be tension between the rotation requirements and the desire to maintain audit quality.

**10** In some cases, auditor rotation may adversely impact on audit quality for a limited time if the new auditor has less experience relevant to the audit of the particular audit client or less specialist knowledge about the particular audit client. The need for specialist skills and knowledge may arise because of:

- (a) the industry in which the audit client operates;
- (b) the complexity of the audit; or
- (c) the audit client's membership of a corporate group structure.

**11** We consider that any adverse impact on audit quality will only be for a limited time and, may be minimised by ensuring that the lead auditor and review auditor do not rotate at the same time (i.e. 'staggering' rotation).

### ***Availability of other registered auditors***

**12** There are more than 5000 RCAs in Australia. Within an audit market of this size we consider that it will usually be possible for an audit client to find an alternative eligible auditor. In some situations that alternative eligible auditor will not be a member, employee or director of the audit client's current audit firm or AAC. However, we consider that changing to a new auditor will generally not impose an unreasonable burden on the audit client.

Note: See the audit industry overview in Schedule 1.



### ***Special audit requirements***

**13** In some circumstances, other legal requirements that apply to the audit of the audit client may affect the availability of alternative eligible auditors. Some audits may only be undertaken by an ‘approved’ auditor. For example, the audit of a life insurance company or a general insurance company may only be undertaken by an auditor approved by APRA: see s84 of the *Life Insurance Act 1995* and s40 of the *Insurance Act 1973*.

**14** In this situation, it might be appropriate to grant relief. However, as our specific relief power is limited, we are unable to provide a long-term solution and you will need to consider what you will do once any relief expires.

### ***What is not an unreasonable burden on the audit client?***

**15** There are some matters that, while clearly relevant, do not by themselves satisfy the unreasonable burden criterion. For example, we do not consider that higher audit costs for the audit client if the new auditor takes longer to conduct the audit because of the new auditor’s need to develop expertise and knowledge of the audit client’s business, alone, prove that compliance with the rotation requirements imposes an unreasonable burden on the audit client. Similarly, the loss of the audit client’s preferred auditor is unlikely, of itself, to satisfy the unreasonable burden criterion.

### **Unreasonable burden on the auditor**

**16** We will consider granting relief where there is an unexpected event that prevents the appointed auditor or the lead or review auditor from continuing with the audit and there is no other auditor in the audit firm or AAC that is eligible to undertake the audit or review.

**17** The event must be truly unexpected. Examples include the sudden death or illness of the auditor. Resignation by the member of an audit firm or director of an AAC will not ordinarily be considered to be an unexpected event as we consider that audit firms and AACs should take into account the rotation requirements in their succession planning.

### ***Smaller audit firms or AACs***

**18** We will consider whether the rotation requirements impose an unreasonably disproportionate burden on an audit firm or AAC because of its size. The rotation requirements were not intended to operate in a way that necessarily requires *audit firm* or *AAC* rotation, rather than *auditor* rotation.

**19** However, while it is clear that we were given the specific relief power with the intention that we use it to ease the burden on smaller audit firms and AACs (and, implicitly, sole practitioners), our relief power is limited. We can only extend the period before which auditor rotation must take place.

**20** You might want to consider ‘staggering’ the appointment of auditors across your audit clients to minimise the impact of the rotation requirements (i.e. so that not all auditors within a firm or AAC are required to rotate at the same time).

### ***Auditors operating in rural and remote areas***

**21** The geographic location of the auditor’s practice will not, of itself, be conclusive of the need to grant relief. It will depend on the particular circumstances of the auditor. We will take into account the number of potential audit clients within a reasonable distance of the auditor and the additional costs (if any) for the auditor if it is necessary to travel further to conduct an audit. However, the need to travel to conduct an audit will not, of itself, provide conclusive proof that an unreasonable burden is imposed.

### ***What is not an unreasonable burden on the auditor?***

**22** Although relevant to the assessment of whether an unreasonable burden has been imposed on the auditor, additional administration costs due to compliance with the rotation requirements will not, of itself, provide conclusive proof that an unreasonable burden is imposed. Similarly, an adverse financial impact on the auditor (for example, through reduced audit fee income or the loss of an audit client) will not, of itself, satisfy the unreasonable burden criterion.

## C How to apply for relief

Policy proposal	Your feedback
<p><b>Contents of your application</b></p> <p><b>C1</b> Your application for relief under s342A should include:</p> <ul style="list-style-type: none"> <li>(a) an explanation of the nature and extent of the burden that will be imposed if relief is not given. Your application might address one or more of the following factors:           <ul style="list-style-type: none"> <li>(i) the administrative costs of compliance (e.g. higher audit fees);</li> <li>(ii) how relief might impact on audit quality (e.g. the new auditor may lack expert knowledge);</li> <li>(iii) how relief might impact on the information needs of users and potential users of an entity’s financial reports;</li> </ul> </li> <li>(b) an explanation as to why relief will not impact unduly on auditor independence and the credibility of the financial reports;</li> <li>(c) a signed acknowledgement from your audit client that they are aware of, and support, your application for relief;</li> <li>(d) written consent from the individual auditor, if the application is made on the auditor’s behalf by an audit firm or AAC, or written consent from the audit firm or AAC, if the application is made by an individual auditor on behalf of an audit firm or AAC; and</li> <li>(e) an explanation of how you and your audit client will ensure that s324DA can be complied with when any relief expires.</li> </ul> <p><b>C2</b> If your application is made on the basis that, without modification, s324DA will impose an unreasonable burden on the audit client, you should generally include information that has</p>	<p><b>C1Q1</b> Do you agree with this approach? If not, why not?</p> <p><b>C1Q2</b> In what circumstances (if any) would you be unable to provide this information?</p> <p><b>C2Q1</b> Do you agree with this approach? If not, why not?</p> <p><b>C2Q2</b> In what circumstances (if</p>

either been prepared, or endorsed, by your audit client outlining the nature and extent of the unreasonable burden.

## When should you apply for relief?

**C3** You should apply for relief *before* you become ineligible to play a significant role in the audit of a particular audit client.

**C4** You should apply for relief as soon as you:

- (a) become aware that you are not eligible to play a significant role in the audit of a particular audit client; and
- (b) conclude that compliance with the rotation requirements will impose an unreasonable burden.

any) would you be unable to provide this information?

**C3Q1** Are there circumstances in which you think it will not be possible to apply for relief before you become ineligible? If so, please give details.

# Explanation

## Contents of your application

**1** You should read Policy Statement 51 *Applications for relief* [PS 51] before applying for relief from s324DA.

**2** Under s342A, an application for relief may be made by:

- (a) the RCA; or
- (b) an audit firm or AAC on whose behalf the RCA acts or would act in relation to the audit or audits.

An audit client cannot apply for relief.

**3** The application must be in writing and signed by the applicant. If the application is made by an RCA who engages, or is to engage, in audit activities on behalf of an audit firm or AAC, the application must include the audit firm's or AAC's written consent to the application. If the application is made by an audit firm or AAC in relation to an RCA, the application must include the RCA's written consent to the application.

**4** You will need to consider what action you will need to take to be able to comply with the rotation requirements after any relief expires. We expect you to tell us in your application for relief how you plan to be able to comply with the requirements once the relief period ends.

### ***Support of the audit client***

**5** The law allows you to make an application for relief without notifying your audit client or obtaining their consent. However, as a matter of good practice, we expect that you will notify your audit client that you intend making an application for relief (*before* you make your application). You might include a signed acknowledgement from your audit client that they are aware of, and support, your application for relief.

**6** Where you are applying for relief on the basis that an unreasonable burden is imposed on the audit client, we would generally expect your application to be supported by a statement in writing and signed by your audit client describing the nature and extent of the burden and why relief would remove or reduce that burden.

**7** Section 342B requires that if relief is granted, the auditor must give the audit client written notice of the declaration made by ASIC under s342A.

## When to apply

**8** An individual's eligibility should be assessed before that individual 'engages in audit activity' in relation to a particular audit client. Section 9 of the Corporations Act provides that an individual auditor, audit firm or AAC:

'... engages in audit activity in relation to an audited body for an audit if the individual auditor, audit firm or AAC:

- (a) consents to be appointed as auditor of the audited body for a financial year; or
- (b) acts as the auditor of the audited body for a financial year; or
- (c) prepares a report in relation to the audited body that is required by this Act to be prepared by:
  - (i) a registered company auditor; or
  - (ii) an auditor of the audited body in relation to a financial year or half-year.'

**9** This definition means that an auditor may engage in audit activity before the financial year begins (i.e. by consenting to act as the auditor under 328A) and certainly well before an audit report is prepared about the financial report as part of a half-year review or for the full financial year.

**10** Our general policy is not to grant retrospective relief: see Policy Statement 51 *Applications for relief* [PS 51] at [PS 51.63]–[PS 51.64]. An application for relief should be made before the auditor becomes ineligible and should allow us sufficient time to make a decision about whether to grant relief. Applications should be made in accordance with [PS 51].

# Regulatory and financial impact

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We have considered the regulatory and financial impact of the policy proposals in this paper. Based on the information currently available to us, we think implementing these proposals will strike an appropriate balance between:

- (a) protecting investors by promoting independence and quality of financial reports; and
- (b) facilitating activity in the audit industry, including not unreasonably burdening audit clients or smaller audit firms and those who operate in rural or remote areas.

To ensure that we have achieved an appropriate balance, we are also developing a Regulation Impact Statement (RIS). All RISs are submitted to the Office of Regulation Review. The RIS will identify all the alternative options that could achieve our objectives. The RIS will also include analysis of the benefits and costs of each of the options, including any restriction on competition for different persons affected.

## Important details sought from you

So that we can more fully assess the financial and regulatory impact of our proposals, in seeking your views, we specifically invite you to comment on:

- (a) other possible options that would achieve our objectives; and
- (b) the likely financial impact of the proposals. In particular, consider the costs and benefits of these proposals. Where possible, we are seeking both quantitative and qualitative data.

Any comments that we receive will be taken into account when preparing our RIS.

**Note:** You may ask us to treat any financial information that you give us as confidential.

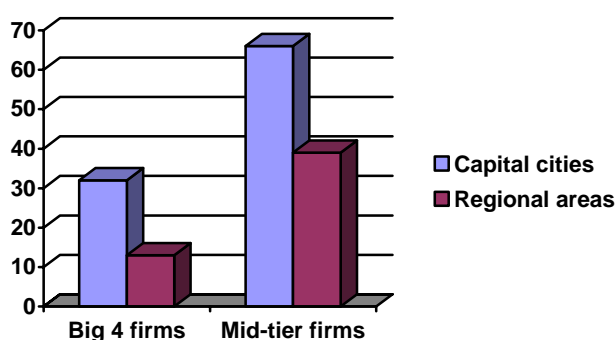
# Schedule 1 Audit industry overview

## Registered company auditors (RCAs)<sup>1</sup>

As at 7 February 2006, there were 5276 RCAs. Of these, 499 worked for the Big 4 accounting firms (i.e. Deloitte Touche Tohmatsu, Ernst & Young, KPMG and PricewaterhouseCoopers), 266 worked in mid-tier firms (i.e. firms that have more than 20 listed clients)<sup>2</sup> and the remainder worked in small firms, as sole practitioners, were no longer active or it was not possible to tell who they worked for.

While we were not able to determine how many auditors worked in each office, we were able to identify the office locations for the Big 4 and mid-tier audit firms. The Big 4 predominantly had offices in the major capital cities (i.e. Adelaide, Brisbane, Canberra, Melbourne, Perth and Sydney). Two of the Big 4 also had offices in Darwin and Hobart. In addition, each of the Big 4 had offices in a range of larger regional centres (e.g. the Gold Coast).<sup>3</sup> Mid-tier audit firms were more likely to have offices outside of the capital cities and larger regional areas (eg. Newcastle, Gold Coast). For example, of Horwath's nine offices, two were outside of the capital cities—in Cairns and Alice Springs. Of RSM Bird Cameron's 29 offices, 23 were outside of the capital cities—3 in regional New South Wales, 2 in regional South Australia, 2 in regional Victoria and 16 in regional Western Australia.<sup>4</sup>

**Table 1: Office locations**



<sup>1</sup> This analysis is based on information obtained from ASIC's *ASCOT* database as at 7 February 2006. Office locations were obtained from the websites of the audit firms.

<sup>2</sup> Bentleys MRI, BDO/BDO Kendalls, Grant Thornton, Hall Chadwick, HLB Mann Judd, Horwath, Moore Stephens, Pitcher Partners, PKF, RSM Bird Cameron, Stanton Partners and William Buck.

<sup>3</sup> The Big 4 firms had 45 offices—32 in capital cities and 13 in regional areas.

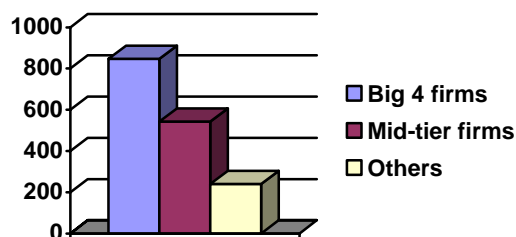
<sup>4</sup> The mid-tier firms had 105 offices—66 in capital cities and 39 in regional areas.



## Listed audit clients<sup>5</sup>

We analysed a sample of listed companies to find out who their auditors were. Of the 1630 companies we looked at, 53% (847) were audited by the Big 4 accounting firms, 33% (543) were audited by mid-tier firms, and 14% (240) by smaller firms and sole practitioners.

**Table 2: Auditors of listed companies**



We also looked at the location of the registered offices of the listed companies. Overwhelmingly, the registered offices were in capital cities. We identified only 75 registered offices that were outside metropolitan areas. Of these, 65 were in major regional centres (e.g. the Gold Coast, Bendigo, Newcastle).

Of the 10 registered offices that were in more remote locations; 3 were in Kalgoorlie, 2 in country Victoria (Allansford and Drouin), 2 in or close to Mt Gambier, 1 in rural NSW (Wee Waa), 1 in the Whitsundays region of Queensland (Airlie Beach) and 1 in the Northern Territory (Tennant Creek). Of these 10 listed companies in remote areas, 5 were audited by the Big 4 or mid-tier firms and 5 by smaller audit firms or sole practitioners. All of these auditors were located in capital cities.

<sup>5</sup> This analysis is based on information obtained from Huntley Aspect's *DataAnalysis* database as at 18 January 2006, <[www.aspecthuntley.com.au](http://www.aspecthuntley.com.au)>.

# Schedule 2 Auditor rotation examples

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Note: Pages 35 and 36 of Schedule 2 were amended on 27 April 2006.

The following examples illustrate how the rotation requirements will apply in particular situations.

Note 1: In the examples we assume that the auditor has not obtained relief under s342A.

Note 2: The time-out rule is contained in s324DA(1) and the 5/7 rule is contained in s324DA(2).

## *Example 1: Individual auditor appointed as the auditor of a listed company*

XYZ Limited is a listed company having a financial year ending on 30 June. Auditor X operates as a sole practitioner. Auditor X has been the auditor for the audit of the company for the following financial years:

- (a) 2001/2002
- (b) 2002/2003
- (c) 2003/2004
- (d) 2004/2005
- (e) 2005/2006

Financial year	01/02	02/03	03/04	04/05	05/06	06/07	07/08	08/09
Eligible to play a significant role in the audit	✓	✓	✓	✓	✓	x	x	✓

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Applying the time-out rule, Auditor X is not eligible to play a significant role in the audit of XYZ Limited until the audit for the financial year 2008/2009. The 5/7 rule would have the same result.

As Auditor X is a sole practitioner, XYZ Limited will need to appoint a new auditor for the financial year 2006/2007. XYZ Limited cannot reappoint Auditor X as its auditor until the financial year 2008/2009.

***Example 2: Authorised audit company appointed as the auditor of a listed scheme***

XYZ Scheme is a listed scheme having a financial year ending on 30 September. Auditor Y is a director of the AAC that has been appointed as auditor by the scheme. Auditor Y has been the lead auditor for the following financial years:

- (a) 2000/2001
- (b) 2001/2002
- (c) 2005/2006

Auditor Y was the review auditor for the following financial years:

- (d) 2002/2003
- (e) 2004/2005

Auditor Y was neither the lead auditor nor review auditor for the financial year 2003/2004.

Financial year	00/01	01/02	02/03	03/04	04/05	05/06	06/07	07/08
Eligible to play a significant role in the audit	✓	✓	✓	—	✓	✓	✗	✓

Applying the 5/7 rule, Auditor Y is not eligible to act as either the lead auditor or the review auditor for the audit of XYZ Scheme for the financial year 2006/2007 (but may act as the lead auditor or review auditor for the financial year 2007/2008).

As Auditor Y's AAC has been appointed as the auditor of XYZ Scheme, another auditor from the AAC can undertake the audit for the financial year 2006/2007 (provided that there is another eligible RCA available within the AAC). Unlike Example 1, in this situation XYZ Scheme does not have to appoint a new auditor.

**Example 3A: Audit firm appointed as the auditor of a listed company**

Audit firm Z has 2 members both of whom are RCAs (Z1 and Z2). Audit firm Z has 3 listed clients (Company A, Company B and Scheme C).

Auditor Z1 has been the lead auditor for Company A since the financial year 1999/2000 (i.e. for 7 successive financial years). Company A's financial year ends on 30 June. Auditor Z2 was the review auditor for the financial years 1999/2000 and 2000/2001, but since 2001 Auditor Z2 has had no involvement in the audit of Company A.

As at 1 July 2006, Auditor Z1 is not eligible to play a significant role in the audit of Company A until the financial year 2008/2009. This means that Auditor Z1 may not act as the auditor of Company A or prepare any audit report for Company A after 1 July 2006, including any half-year review.

Financial year	99/00	00/01	01/02	02/03	03/04	04/05	05/06	06/07	07/08	08/09
Lead auditor = Auditor Z1	✓	✓	✓	✓	✓	✓	✓	x	x	✓
Review auditor = Auditor Z2	✓	✓	—	—	—	—	—	—	—	—
Lead auditor = Auditor Z2	—	—	—	—	—	—	—	✓	✓	✓

As Auditor Z2 has not played a significant role in the audit of Company A since the financial year 2000/2001, Auditor Z2 is eligible to act as the lead auditor for the financial year 2006/2007 and following years (subject to the rotation requirements) and Company A will not need to appoint a new auditor ie. Audit firm Z will not be required to rotate.

***Example 3B: Audit firm appointed as the auditor of a listed scheme***

Audit firm Z has 2 members, both of whom are RCAs (Z1 and Z2). Audit firm Z has 3 listed clients (Company A, Company B and Scheme C).

Auditor Z1 has been the lead auditor for Scheme C since the 2001/2002 financial year. Auditor Z2 has been the review auditor for Scheme C since 2001/2002 with the exception of financial year 2002/2003 when Auditor Z3 (a former member of the firm who has since retired) was the review auditor.

Financial year	01/02	02/03	03/04	04/05	05/06	06/07	07/08	08/09
Lead auditor = Auditor Z1	✓	✓	✓	✓	✓	x	x	✓
Review auditor = Auditor Z2	✓	—	✓	✓	✓	✓	x	✓

Auditor Z1 will not be eligible to play a significant role in the audit of Scheme C for either financial years 2006/2007 or 2007/2008 and will have to comply with the 'time-out' period of 2 years (i.e. Auditor Z1 cannot act as the lead auditor or review auditor until financial year 2008/2009).

Auditor Z2 may continue to act as review auditor for the 2006/2007 financial year but then cannot act as lead auditor or review auditor before the financial year 2008/2009 because Auditor Z2 will have played a significant role in the audit of Scheme C for 5 out of 7 successive financial years (i.e. from financial year 2001/2002 until financial year 2007/2008).

In this example, neither Auditor Z1 nor Auditor Z2 is eligible to act as the lead auditor or review auditor of Scheme C for the financial year 2007/2008. Auditor Z1 is ineligible as Auditor Z1 has been the lead auditor for 5 successive financial years. Auditor Z2 is also ineligible to act as the lead auditor or review auditor as to do so would mean that Auditor Z2 would play a significant role in the audit of Scheme C for more than 5 out of 7 successive financial years.

As neither Auditor Z1 nor Auditor Z2 is eligible to act as the lead auditor or review auditor for the financial year 2007/2008, Scheme C will need to appoint a new auditor.

# Key terms

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In this policy proposal paper, terms have the following meaning:

**5/7 rule** The auditor rotation obligation in s324DA(2) of the Corporations Act

**AAC** An authorised audit company registered under Pt 9.2A of the Corporations Act

**APRA** The Australian Prudential Regulation Authority

**AUASB** The Auditing and Assurance Standards Board

**audit client** The listed company or listed registered managed investment scheme in relation to which the auditor engages in audit activity

**auditor rotation** The requirement in s324DA of the Corporations Act

**AUS 206** Auditing and Assurance Standard AUS 206 *Quality Control for Audits of Historical Financial Information* (June 2004)

**CLERP 9 Act** *The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*

**Corporations Act** *The Corporations Act 2001*

**engages in audit activity** Has the meaning given in s9 of the Corporations Act

**lead auditor** The ‘registered company auditor who is primarily responsible to the audit firm or AAC for the conduct of the audit’

Note: This is a definition contained in s324AF(1) of the Corporations Act.

**listed scheme** A listed registered managed investment scheme

**plays a significant role** Has the meaning given in s9 of the Corporations Act

**PS 51** (for example) An ASIC policy statement (in this example numbered 51)

**RCA** A registered company auditor

**review auditor** The ‘registered company auditor (if any) who is primarily responsible to the individual auditor, audit firm or AAC for reviewing the conduct of the audit’

Note: This is a definition contained in s324AF(2) of the Corporations Act.

**RIS** A regulation impact statement

**rotation requirements** The time-out rule and the 5/7 rule

**time-out rule** The auditor rotation obligation in s324DA(1) of the Corporations Act

# What will happen next?

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## Stage 1

12 April 2006 ASIC policy proposal paper released

## Stage 2

26 May 2006 Comments due on the policy proposal paper

June 2006 Drafting of policy statement

## Stage 3

End June 2006 Policy statement released

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### Your comments

**We invite your comments on the proposals and issues for consideration in this paper, including the explanation sections.**

**We will not treat your submission as confidential unless you specifically request that we treat the whole or part of your submission as confidential. If your submission includes financial information, we will consider a request from you that we treat that section of your submission as confidential.**

**Comments are due by 26 May 2006 and should be sent to:**

**Ms Joanna Bird  
Assistant Director  
Regulatory Policy  
Australian Securities and Investments Commission  
GPO Box 9827  
Sydney NSW 2001  
facsimile 02 9911 2316  
email: [policy.submissions@asic.gov.au](mailto:policy.submissions@asic.gov.au)**

**You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.**

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