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Dear Douglas

Consultation Paper 209: Resignation, removal and replacement of auditors: Update to RG 26

The Governance Institute of Australia is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our Members, due to their involvement in governance and corporate administration, have a thorough working knowledge of the *Corporations Act*, and liaise with the Australian Securities and Investments Commission (ASIC) regularly in the course of their work.

Our Members have identified a variety of issues, at both the process and policy levels, in relation to the appointment, resignation and removal of auditors. At a number of meetings held with ASIC during 2006—2009 (when we were known as Chartered Secretaries Australia), we raised concerns that the mechanism for notifying the appointment of an auditor does not currently operate efficiently and effectively. 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.

We welcomed the discussions with ASIC on this issue and now welcome *Consultation Paper 209: Resignation, removal and replacement of auditors: Update to RG 26* (the Consultation Paper). Below we set out the issues we have identified, some of which are partially addressed by draft Regulatory Guide 26 and some of which are not. Rather than address each question raised in the Consultation Paper, Governance Institute of Australia Members have taken this opportunity to set out again the range of issues that ASIC regulatory guidance needs to address, in order to ensure that the process difficulties currently in place — that undermine the intent of the policy — can be ameliorated.

Governance Institute of Australia hopes that ASIC is able to effect the changes we recommend, some of which go beyond the matters set out in the Consultation Paper. We are of the view that all of these matters need to be considered as a whole.

1 Consenting to resignations, removals and replacements

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. We note 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.

Governance Institute of Australia 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. 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.

Governance Institute of Australia 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.

Benefits of creating a new form

We note 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.

ASIC has advised this organisation that the original Form 315 had included questions relating to the appointment of auditor and change of name of auditor. At the time of the repeal of the annual return, as part of the reduction in regulation to which companies are subject, ASIC did not consider it appropriate to create a new form. The creation of a new form would have undermined the reduction in red tape that was being enacted.

We have discussed with ASIC how our Members can notify ASIC of the appointment of the auditor when no form exists for such notification. At present, some public listed companies that have taken advantage of the relief whereby accounts lodged with ASX are deemed to be lodged with ASIC attach a covering letter to Form 315 or send in a stand-alone letter notifying ASIC of the appointment of the auditor.

There are a number of problems associated with attaching a covering letter or sending a stand-alone letter:

- It is not commonly known that a covering letter attached to Form 315 or a stand-alone letter could be required to ensure that ASIC has a record of the appointment of the auditor as this is an informal process that has been arrived at by trial and error on the part of our Members.
- Large public listed companies are familiar with regulatory challenges and frequently have the resources to manage them, and thus may well arrive at the solution of attaching a covering letter or sending in a stand-alone letter after contact with ASIC. However, newly listed and start-up companies do not understand why a covering letter should be attached to a form or why a stand-alone letter that is not requested should be sent in, but wish the form to be available from ASIC so that their regulatory obligations and the process attached to them are clear.

We note that, at present, when a company that has not lodged a Form 388 or provided a covering letter attached to Form 315 or a stand-alone letter notifying ASIC of the appointment of an auditor can face considerable time and effort in remedying the problems arising from the current situation. Indeed, the time and effort devoted to remedying the situation, which can run into many hours of extended correspondence and contact with ASIC by company secretaries or other officers, is considerably greater than the time and effort that would be involved in filling out a one-page form notifying ASIC of the appointment of an auditor.

Costs of current situation

Governance Institute of Australia Members who have had to grapple with the current situation point to the difficulty in quantifying the costs attached to remedying the current situation, as the hours spent on unravelling the problem caused by the absence of information held by ASIC on this front vary from company to company.

However, the costs involved relate to:

- management time
- efforts devoted to clarifying a situation whereby the company has fulfilled its compliance obligations, but there is no record of it having done so, including providing copies of documents to support that a company has fulfilled its compliance obligations, when no formal process exists for such confirmation
- the potential for delays in AGMs, where the auditor is being replaced, but ASIC will not grant permission for the auditor to resign given it has no record of the appointment. This is a cost borne directly by shareholders.

The costs attached to the current situation extend to the relief granted to listed public companies whereby accounts lodged with ASX do not also need to be lodged with ASIC with Form 388 is rendered null and void, as companies are advised that it is preferable that they

lodge Form 388 with ASIC to avoid the problem of ASIC being unaware of the appointment of an auditor.

Costs attached to having to comply by filling out a new form

Governance Institute of Australia Members confirm that it would take them approximately ten minutes to fill out a one-page form notifying ASIC of the appointment of an auditor.

Our Members note that the Consultation Paper does not address the issues we have set out here on notification to ASIC of appointment or cessation of the auditor.

Governance Institute of Australia strongly recommends that these issues be addressed as part of the update to Regulatory Guide 26, with a new form created by ASIC to fulfil the compliance obligations as set out above.

b) Guide to Form 315

Governance Institute of Australia 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.

Governance Institute of Australia also 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.

We note 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).

Governance Institute of Australia recommends that the Guide to Form 315 contain the correct references.

Governance Institute of Australia 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

Our 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. We note 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. Our Members therefore cannot advise ASIC of a resignation that did not occur.

We note 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.

c) Exceptional circumstances when consent may be granted

Currently, ASIC draft Regulatory 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.

Entities should plan their audit tendering processes to ensure that auditors know whether their appointment will be continuing at the time of completing the audit and that any resignation takes effect at the next AGM.

Companies need to fulfil their statutory obligations, and we request ASIC to consider the very real practical difficulties attached to an insistence that tendering not be considered an example of an early consent circumstance. In each instance, we understand that ASIC may decide not to grant consent, but we recommend that it be possible to seek consent in these circumstances.

Governance Institute of Australia recommends that Regulatory Guide 26 provide:

1. 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.)

d) Auditor resignations, removals and replacements under other legislation

a) Need for consistent regime

Governance Institute of Australia 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.

We note 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.

We have long recommended 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.

Governance Institute of Australia therefore supports ASIC's proposal to incorporate into the regulatory guide its guidance on the provisions of the Corporations Act and National Credit Regulations that relate to auditor resignation, removal and replacement, subject to the process issues that we have set out above also being taken into account.

b) Member appointment of auditor in single-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 AGM (s 327A)). Under s 327B, a public company must appoint an auditor at its first AGM. However, when the public company is a single-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.

Governance Institute of Australia strongly supports ASIC's proposal that it can consent to the resignation of an auditor of a single-member public company that does not hold an AGM to take effect within one month after the lodgement of the audit report; and that where early consent circumstances exist, it may consent to a resignation outside this period. CSA believes that the member or members should always appoint the auditor as a matter of principle but if there is no AGM this is not possible.

2 Other matters

a) Application and consent to resign

Form 342

We note that when an auditor wishes to resign, ASIC consent is required. Governance Institute of Australia 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 we support, 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, we note that, due to the reasons we set out above in relation to the challenges arising from the lack of a form for notification of appointment of auditor, 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

We note 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, we are of the view 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.

Governance Institute of Australia 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.

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

The Consultation Paper does not address the need to provide for different requirements when takeovers occur and the auditor is the same for both the acquiring and target companies.

We note 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, we 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.

Governance Institute of Australia 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. We are of the view that Regulatory Guide 26 could address this matter.

b) Notification of application to resign

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

However, **Governance Institute of Australia 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, or of knowing when and if ASIC has received that application.

Our Members note that this issue is not canvassed in the Consultation Paper, but are of the view that this matter should also be addressed.

c) Application and consent to replace auditor where conflicts of interest arise and the auditor agrees to be removed or resign

We note that ASIC will not approve an application to resign and an appointment of a new auditor at any time other than an AGM. As noted above, we support the policy objective, which is to protect shareholders and ensure that the directors are not applying pressure on the auditor to resign.

However, we note that conflicts of interest can arise and it is in the interests of shareholders to ensure that an auditor can be replaced at the time the conflicts arise, rather than at the next AGM, which can be many months away. In such cases, if ASIC refuses the application to replace the auditor, the auditor continues to have access to confidential financial documents that they should not have access to. This is not in shareholders' best interests.

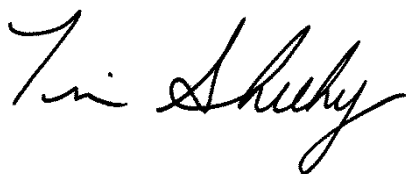
Governance Institute of Australia would support a process whereby ASIC interviews each party to ensure that the application to remove the auditor or for the auditor to resign is related to conflicts of interest and not for any other reason. However, we do not support ASIC simply refusing consent because the application is not at the time of the AGM, as such refusal penalises shareholders and cannot be said to be fulfilling ASIC's responsibility to protect investors.

Governance Institute of Australia recommends that ASIC consider an application to replace an auditor where conflicts of interest arise and the auditor agrees to be removed or resign at times other than the AGM, subject to any conditions that ASIC may consider appropriate.

Conclusion

Our Members have discussed these issues with ASIC over some years, and note that the process of the appointment, resignation and removal of auditors remains overly complicated and cumbersome. Our Members support the policy objectives that ASIC seeks to fulfil, but note that those policy objectives could still be fulfilled while reducing the complexity of the current process. We hope that our submission on these matters will be considered in this light and that further changes to Regulatory Guide 26 and other ASIC materials can be made.

Yours sincerely

A handwritten signature in black ink, reading "Tim Sheehy". The signature is written in a cursive, flowing style.

Tim Sheehy
Chief Executive