



ASIC

Australian Securities & Investments Commission

REPORT 437

Response to submissions on CP 209 Resignation, removal and replacement of auditors: Update to RG 26

June 2015

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 209 *Resignation, removal and replacement of auditors: Update to RG 26* (CP 209)—in particular, those issues that arose out of our second round of consultation to CP 209. It details our responses to those issues.

About ASIC regulatory documents

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

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

Regulatory guides: give guidance to regulated entities by:

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

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

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

Disclaimer

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

This report does not contain ASIC policy. Please see Regulatory Guide 26 *Resignation, removal and replacement of auditors* (RG 26).

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A Overview/Consultation process

- 1 In Consultation Paper 209 *Resignation, removal and replacement of auditors: Update to RG 26* (CP 209), we sought feedback on our proposals for updating our guidance in Regulatory Guide 26 *Resignation of auditors* (RG 26) on the resignation, removal or replacement of auditors of:
 - (a) public companies;
 - (b) registered managed investment schemes (registered schemes) and compliance plans;
 - (c) Australian financial services (AFS) licensees; and
 - (d) credit licensee trust accounts.
- 2 When CP 209 was issued in May 2013 (together with a draft updated RG 26) the main question was whether we should change our fundamental policy position that our consent for an auditor to resign other than at an annual general meeting (AGM) would generally only be approved in exceptional circumstances.
- 3 The existing RG 26 only addressed our approach for public companies, and so the draft updated RG 26 also illustrated how our approach would apply for registered schemes, AFS licensees and credit licensee trust accounts.
- 4 We received eight responses to CP 209 from accounting firms, professional bodies and others. We are grateful to respondents for taking the time to send us their comments.
- 5 A number of the submissions received in response to CP 209 would require legislative changes. Accordingly, these matters will be considered and discussed with Treasury.

A fundamental change in approach

- 6 After considering the responses to CP 209, international practice and potential burdens on business, in early 2014 we decided to fundamentally change our approach.
- 7 Broadly, under our new approach, we proposed that:
 - (a) we would consent to the resignation of an auditor at any time of the year unless we have concerns, such as evidence of a disagreement between the outgoing auditor and management on an accounting treatment or other evidence that we should not provide our consent; and
 - (b) our consent would depend on separate disclosures being made by public companies and registered schemes about the change of an auditor.

- 8 Based on these proposals, we revised the draft updated RG 26 and consulted further with each of the eight respondents to CP 209 about the implementation of this change in our policy.
- 9 Six formal responses were received from this second round of consultation. We are grateful to respondents for taking the time to send us their comments. We are also grateful to the individuals who discussed specific issues with us during the consultation process.
- 10 For a list of the five non-confidential respondents to the second round of consultation to CP 209, see the appendix. Copies of the non-confidential submissions are on our website at www.asic.gov.au/cp under CP 209. We also received one confidential submission.
- 11 Given the fundamental change in our approach, this report focuses on responses received to the second round of consultation. As noted in paragraph 4, this report does not cover matters raised by respondents that would require legislative changes.
- 12 All respondents to the second round of consultation were supportive of, or did not oppose:
- (a) a change in policy whereby we would consent to the resignation, removal or replacement of an auditor at any time of the year, subject to certain conditions;
 - (b) outlining in the revised draft updated RG 26 the important roles directors and audit committees play in ensuring the independence of auditors and promoting audit quality; and
 - (c) enhancing the clarity in the revised draft updated RG 26 about how to apply for our consent for the resignation, removal or replacement of an auditor.
- 13 Some respondents expressed concern that one or more of the following may impose additional regulatory burdens:
- (a) some of our criteria for consent;
 - (b) the requirement for certain information to be lodged with the application for consent; and
 - (c) for public companies and registered schemes, the requirement for disclosure notices or communications to members about the resignation or removal of an auditor.

These concerns and our responses to them are outlined in Section B.

B Our proposals in the second round of consultation

Key points

This section outlines the key issues covered in submissions in the second round of consultation, and our responses to those issues.

It covers concerns expressed in some submissions about:

- some of the criteria that we would consider in deciding whether to give our consent to the resignation, removal or replacement of an auditor;
- certain information required to be provided in connection with the incoming auditor and the effectiveness of their audit; and
- the requirement for certain entities to notify ASIC and the relevant market operator and/or members of a change in auditor.

Our criteria for consent

- 14 Our revised draft updated RG 26 provided that we will generally give our consent to the resignation, removal or replacement of an auditor if a number of criteria are met.
- 15 Concerns were expressed about some of the criteria for consent—in particular, that:
 - (a) there are no disagreements with the management or directors on matters such as accounting treatments;
 - (b) the auditor has not provided an adverse or disclaimer opinion or qualifications within the two most recent financial years and any subsequent interim period;
 - (c) all outstanding audited financial reports and other documents requiring audit have been lodged;
 - (d) the change in auditor does not appear to be connected in any way with opinion shopping; and
 - (e) a replacement auditor has been identified.
- 16 Respondents were concerned that auditors should not be prevented from resigning where there is a disagreement with management or directors because this demonstrates the auditor is free from bias and undue influence from others in undertaking their audit obligations. Our concern was that some directors might, for example, seek to change an auditor to one that may be willing to accept an inappropriate accounting treatment.

- 17 Respondents suggested that there is no correlation between the delivery of a modified opinion, and the principles of having an appointed auditor who is competent and objective. It was further suggested that auditors should not be penalised for providing such an opinion and, in rare circumstances, this may have the unintentional consequence of affecting the outcome of an audit.
- 18 Respondents had concerns that requiring all outstanding audited financial reports and other documents requiring audit to have been lodged may be inconsistent with free and efficient capital markets, and does not have sufficient nexus to providing members with timely information.
- 19 While respondents agreed that there should be restrictions on consent to a change of auditor due to opinion shopping, it was suggested that we clarify that an entity seeking independent accounting advice in certain situations is not discouraged or precluded.
- 20 One respondent was concerned that a replacement auditor would generally need to be found before we consented to the resignation of the incumbent auditor.

ASIC's response

As a result of the feedback received, we have reworded, redesigned and clarified our guidance in RG 26. In particular, we have:

- stated that we will consider the 'nature and extent of any disagreements' with the entity's management or directors that are of concern to us, rather than indicating that there should be 'no disagreements', to clarify that there could be instances when disagreements would not prevent us from consenting to the resignation of an auditor;
- clarified that we will have regard to an application for the resignation, removal or replacement of an auditor that may be connected with the provision of a modified audit opinion within the two most recent financial years and any subsequent interim period to ensure there is no evidence of opinion shopping;
- removed the requirement that all outstanding audited financial reports and other documents requiring audit be lodged before our consent is given;
- clarified that an entity is generally not precluded from obtaining accounting advice from an independent source that is in no way connected with a possible future change in auditor; and
- retained our approach to requiring that a replacement auditor be found before we consent to the resignation of the incumbent auditor because it would generally be in the public interest for the entity to continue to have an audit.

Information to be lodged with the application

- 21 Concerns were expressed that we were proposing increased requirements for information to be provided with all applications for our consent and, in particular, for those that will take effect at the next AGM of a public company.
- 22 The revised draft updated RG 26 required the outgoing auditor to provide information with their application on the timing of the proposed resignation and its impact on the effectiveness of the audit by the incoming auditor. Some respondents considered that this was a matter for the incoming auditor, and therefore suggested removing this requirement.
- 23 Respondents also raised concerns about potential duplication of additional information to be provided by the entity and the incoming auditor.

ASIC's response

We have amended RG 26 to include information requirements that were previously listed only on the relevant ASIC application form. The information to be included in applications for our consent has not been increased.

We have removed the requirement for the outgoing auditor to provide details of the impact of the timing of the proposed resignation on the effectiveness of the audit process.

We have reworded and redesigned some of our guidance to improve clarity.

Disclosure to the market and members

- 24 The revised draft updated RG 26 provided that for public companies and registered schemes that are disclosing entities, our consent to the resignation would be conditional on separate market disclosures being made about:
- (a) details of the outgoing auditor;
 - (b) details of the proposed incoming auditor; and
 - (c) the reason for the change in auditor.
- 25 The revised draft updated RG 26 required this disclosure to be made in a separate release at the time the resignation took effect, unless the change occurred at an AGM of a public company.
- 26 Concerns were expressed that this requirement would impose an unnecessary increase in regulation, given that disclosing entities already have continuous disclosure obligations and, in some cases, the reason for the change of auditor may be confidential or sensitive.

ASIC's response

After carefully considering the feedback received, we have not amended the requirement for market and other disclosures because in our view our fundamental change in policy is underpinned by the need for transparency of the change in auditor and maintaining audit quality.

Given the significance of the circumstances surrounding a change in auditor, we consider that these disclosure requirements need to be a specific condition of our consent, rather than just relying on the general continuous disclosure obligations.

We further consider that the level of detail required to be disclosed is not onerous.

Appendix: List of non-confidential respondents

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| <ul style="list-style-type: none">• Deloitte Touche Tohmatsu• EY• KPMG | <ul style="list-style-type: none">• Governance Institute of Australia• Joint submission by the Institute of Chartered Accountants in Australia and CPA Australia |
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