



Notices of auditors leaving office: consultation on simplification for companies and auditors

BIS discussion paper

*Response by the
Local Authority Pension Fund Forum
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Private and confidential

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Introduction

The Local Authority Pension Fund Forum (LAPFF) was set up in 1991 as a voluntary association of local authority pension funds based in the UK. It exists to promote the long term investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest. The Forum's 50 members currently have combined assets of over £80 billion.

LAPFF considers audit to be the third line of defence against malpractice; the first two being the integrity of the directors and management and the company's internal governance.

In January 2007, LAPFF reported to members its overall agenda on audit practices and reporting and adopted a monitoring policy to enhance its focus on audit committee best practice. This agenda was a result of particular governance concerns over various developments in the audit profession.

LAPFF considers that it remains important for shareholders in all publicly listed companies to continue to receive both the statement from the auditor and from the company as to the circumstances around the departure of the auditors.

LAPFF considers the following action is required;

- to maintain the current framework of the 2006 Companies Act regarding auditor's resignation.

The Forum has taken this opportunity to provide its views to question three of the consultation, which is considered most relevant to its concerns.

3. (a) Do you consider that the current regulatory framework for notifications of auditors ceasing to hold office, as it applies to auditors for major audits, should be maintained in its current form or is there scope for change?

3.1. We would like to stress the importance for shareholders to always receive both the statement from the auditor and from the listed company as to the circumstances around their departure. We consider the recommendations published by the Institute of Chartered Accountants on Audit Quality¹ in 2005 should be adhered to and their implementation into the 2006 Companies Act should be maintained in their current form.

3.2. Our views are based on the “agency relationship” that exists between the shareholders and the board of directors. The primary objective of an audit of the financial statements is to address this issue by providing independent assurance to the shareholders that the directors have prepared the financial statements “properly”.² However, there are perceived transparency issues for shareholders around the effectiveness of an audit. This is particularly important when an auditor is leaving office. LAPFF considers the reasons behind the auditor’s decision to resign should in all cases be made available to shareholders within the current legal threshold of 14 days.³

3.3. LAPFF supports the position that the auditors of all listed companies, both for major and non-major audits, should continue to send to the company a statement of circumstances and that the company be required to circulate it to its members and others entitled to receive the annual accounts. We understand that the consultation proposes leaving the requirements for major audits unchanged. However, we have concerns over the suggested amendment to non-major audits and do not consider it sufficient that the statement of circumstances should say (i.e. at the auditor’s option) whether the reasons should be drawn to the attention of shareholders and creditors, as suggested in the consultation.

3.4. Our concerns are based on the issue that if a resignation statement is not legally required, auditors may resign and ‘go quietly’ leaving the shareholders unaware of any potential problems within the company”.⁴ This can be illustrated by the high profile court case between Jarvis plc and its resigning auditors, PricewaterhouseCoopers in 2000, where Jarvis plc made an application to the court, in accordance with the previous legal requirement under Section 394 of the Companies Act 1985, ‘to decide if the auditor is using the statement to secure needless publicity for defamatory matter’.⁵ As a result of the court proceedings, the statement to shareholders and creditors was suspended and it was not until after the court proceedings that the company issued a statement to the shareholders. For four months, shareholders were unaware of the reasons for the auditor’s resignation and this was reflected in a drop in the share price and thus a decrease in shareholder value.

¹ The Institute of Chartered Accountants, Audit Quality, Shareholder involvement – Auditor resignation statements, 2005

² House of Commons Treasury Committee; Banking crisis: reforming corporate governance and pay in the City; Ninth Report of Session 2008-09; 15th May 2009.

³ Companies Act 2006, 517 (1)

⁴ The Institute of Chartered Accountants, Audit Quality, Shareholder involvement – Auditor resignation statements, 2005

⁵ Ibid

3. (b) Do you consider that the current framework, as it applies to companies subject to major audit, should be amended to reduce the regulatory burden?

Whilst there may be a regulatory burden for companies, the current framework does provide the best safeguards for shareholders of listed companies. Therefore, we consider that the current legal framework should be retained as discussed in question 3. (a), and that appropriate electronic disclosure of relevant correspondence should be facilitated.