Audit and
Assurance Faculty

AuditQuality@

Shareholder involvement – Questions to the auditor

How can shareholders be empowered to put questions to auditors of listed companies? Consideration will be given to recent reforms in Australia whereby shareholders can write to auditors with questions relating to the audit report or conduct of the audit.

AuditQuality@

Supporting shareholder involvement

The *Audit Quality Forum* brings together the audit profession, investors, business and regulators. Their purpose is to work together to generate policy proposals that will further enhance confidence in the independent audit by promoting transparency and accountability.

The Institute of Chartered Accountants in England and Wales, through the Audit and Assurance Faculty, convenes the *Audit Quality Forum*. The Institute initiated its *Audit Quality* programme in 2002 to drive thinking and practice in the field of audit and assurance. Alongside the Institute's *Information for Better Markets* campaign, the Forum is about working in the public interest to promote quality and confidence in corporate reporting.

The focus of the current agenda is to support shareholder involvement in the audit process. This is just the first stage. To quote from *Audit Quality*, 'Auditing is not a static discipline: committed professionals in any field strive for improvement and audit is no exception.'

There is more work to be done through the *Audit Quality Forum* to explore a broader agenda of issues relevant to the shareholder community.

Further information on the *Audit Quality Forum*, the current work programme and how to get involved is available at **www.icaew.co.uk/auditquality** or contact 020 7920 8493.

Anyone interested in providing feedback on this policy proposal may send comments to **katharine.bagshaw@icaew.co.uk**.

The Audit and Assurance Faculty's publication, *Audit Quality*, identified client relationships, including the effective management of client portfolios and working with individual clients, as one of the key drivers of audit quality. Whilst auditors deal with the directors and management of the company on a day-to-day basis when carrying out their audit, their ultimate responsibility is to the shareholders. The client relationship needs to be managed effectively so that auditors can perform their audit and provide an independent opinion to the shareholders on the truth and fairness of the financial statements which have been prepared by the board.

The statutory audit is a means of addressing issues that arise from the agency relationship that exists between the shareholders and the board of directors. There are, however, perceived transparency issues for shareholders around the effectiveness of audit as a solution to agency problems, including the nature of shareholder involvement and the availability of choice in the audit market.

The *Audit Quality Forum*, launched in December 2004, identified four initial measures that may improve audit transparency and bring real benefits to shareholders as well as the longer-term issue of competition and choice. The Institute established working parties with representation from key stakeholders to take the matters forward and identify technical and practical issues for discussion at the *Audit Quality Forum* on 7 March 2005 and to report on how these matters may be taken forward to implementation.

This policy proposal considers the empowering of shareholders to put questions to auditors of listed companies on relevant matters at AGMs.

ISBN 1 84152 316 X

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Shareholder involvement – Questions to the auditor

Preface

In the light of shareholder concerns, this report sets out a policy proposal to improve transparency by enabling shareholders to put questions to auditors of listed companies on relevant matters at AGMs.

This proposal is part of a series of reports produced to enhance the statutory audit. The report was produced by a working party, details of which are included in Appendix 3. The proposal was considered by participants at the *Audit Quality Forum* on 7 March 2005.

Broad consensus was reached on this proposal with the following matters being identified for further consideration:

> The different needs of private and institutional investors and the issues surrounding boilerplate answers.

> Would expectation gap issues be addressed by questioning of auditors?

> Should the proposal only be a requirement of listed companies even though it could apply to companies quoted on any market place? If so, how should listed companies be defined?

> Are issues surrounding the auditors' duty of care arguments for (a) not allowing questions or (b) arguments in favour of legislation?

> Had the working group considered the role of audit committee chairmen at the AGM? It was noted that the working party had considered this issue. It would probably be necessary to involve other parties working on corporate governance matters including the Institute of Chartered Secretaries and Administrators.

> The quality of responses to written questions of which the auditor has advance notice would probably be better than those for which no notice had been given.

The report has not been amended in respect of the above matters. It is being published so that the appropriate government and regulatory bodies can take such action as they consider appropriate in accordance with their own due process.

Contents

Executive summary

The *Audit Quality Forum* provides stakeholders with an opportunity to discuss issues around audit transparency and accountability. As a consequence of the Forum meeting in December 2004, a number of issues around shareholder involvement were raised and working parties were set up to consider various aspects with the objective of making recommendations to address shareholder concerns.

The working party that has produced this policy proposal was established to consider the empowerment of shareholders to put questions to auditors of listed companies on relevant matters at AGMs. In achieving that objective it was asked to consider the technical, practical and legal issues around the proposal to adopt reforms similar to those very recently introduced in Australia.

In reaching its recommendations, the working party was particularly mindful of the need to provide shareholders, companies and auditors with workable proposals that would be acceptable to all parties and, in particular, proposals that would satisfy the needs of shareholders without extending the auditors' duty of care. Achieving full consensus in this area may take time, not least because some companies remain to be convinced that there is a real problem here, and auditors are concerned about the implications of any changes for the auditors' duty of care. Areas in which consensus was reached, and areas in which further work is needed are outlined in this proposal.

The working party is committed to achieving the substance of the enhanced transparency that shareholders seek. The working party strongly believes that the AGM is a valuable forum for both private and institutional shareholders. But this working party, probably more than any other within the initial series of the *Audit Quality Forum*, needs to deal with the significant legal implications involved in empowering shareholders to ask questions and to balance carefully the concerns of shareholders, companies and their auditors. Furthermore, the Australian legislation is new and its effects have yet to become clear. The working party considers that there is a real risk that overly hasty legislative action might result in situations in which shareholders do not actually get the transparency they seek.

The working party considered how legislation and/or best practice guidance could be best used to meet shareholder needs whilst ensuring that the auditors' duty of care is not extended and that the administrative burden on companies and their auditors is not excessive. The working party recommends that a combination of these approaches be taken. The detailed reasoning for the approach recommended is set out in the body of this proposal. Whilst legislation could provide auditors with a clear statutory protection on duty of care issues, the working party cautions against wholesale import of the Australian model at this time because its effects have yet to emerge. Best practice guidance would need to be developed in consultation with companies, shareholders and auditors. The involvement of the Institute of Chartered Secretaries and Administrators (ICSA) might be helpful in developing proposals. It has been suggested by some members of the working party that such guidance might usefully be incorporated into the Combined Code as this already deals with reporting by, and the questioning of, audit committee chairmen at AGMs. Other members considered that the Auditing Practices Board might provide guidance in certain areas.

The recommendations set out below are less well developed than the recommendations of other working parties for the reasons set out above. **Nevertheless, the working party has made considerable progress in bringing the thought processes of interested parties closer together, although there is more work to be done before a full consensus can be reached.**

The recommendations of the working party are that:

> shareholders should be given a statutory right to put questions in writing to the auditor, via the company, in advance of the AGM; the working party concluded that dealing with the attendance of auditors and directors at AGMs in legislation and/or best practice requires further assessment;

> the provision to shareholders of a list of questions at the start of the AGM, should be dealt with in best practice guidance;

> chairmen at AGMs should retain the right to determine how questions are dealt with at the AGM in order to preserve the orderly conduct of the AGM;

> in order for any legislation or best practice guidance to be effective, the auditors' duty of care, which is to shareholders as a body and not to individual shareholders, must not be extended beyond its current scope; and

> the DTI should consider the implications of the Combined Code, the Company Law Review and the outcome of its 1996 consultation on the questioning of directors at AGMs in determining the way forward; in particular, the working party concluded that the nature of any guidance on the scope and nature of questions that may be asked, and to whom questions should be addressed, requires further assessment.

Questions to the auditor: the issue

The working party was asked to consider the empowerment of shareholders to put questions to auditors of listed companies on relevant matters at the AGM, considering the recent developments in Australia in this area.

The working party focussed on the following areas:

> the different categories of shareholder and their differing needs in the light of recent developments in shareholder communications such as the introduction of the July 2003 Combined Code and the forthcoming statutory Operating and Financial Review;

> how auditors can meet the needs of shareholders without extending their duty of care;

> the statutory and common law framework in the UK compared to the position in Australia. This included consideration of who is responsible for answering questions and the respective responsibilities of directors and auditors; and

> the relative merits of legislation and/or best practice.

Considerable progress was made in identifying the issues that need to be resolved in dealing with questioning of auditors at AGMs. In particular, the working party concluded that private and institutional shareholders have different needs and that differing solutions may need to be found to meet those needs, although the rights of private and institutional shareholders are the same.

The scope of questions to be put and to whom?

The Australian legislation provides for four categories of question that may be put to auditors; the conduct of the audit, the audit report, accounting policies and auditor independence. Some members of the working party felt strongly that accounting policies should be included within the scope of legislation and/or best practice guidance, others considered that questions to auditors on accounting policies were inappropriate. A significant number considered that accounting policies were effectively covered under the heading 'conduct of the audit'. The working party debated to whom such questions should be put – directors, auditors or both – and how this could be managed, particularly where conflicts between directors and auditors arise. Some members of the working party considered that the scope of permissible questions should be set out in legislation, others that it should be dealt with in best practice guidance, others again considered that neither legislation nor guidance were necessary or appropriate.

Directors, auditors, or both?

The Australian legislation requires directors to allow shareholders a reasonable opportunity to ask questions of directors and to make comment on the management of the company. Corporate and shareholder members of the working party did not consider that it was necessary for either legislation or best practice guidance to deal with the attendance of directors at AGMs, or with questions that may be put to directors. Other members of the working party considered that it would be anomalous to require auditors to attend and to determine the nature of questions that may be put to them, but not to do the same for directors.

Lists of questions

Some shareholder members of the working party believe that it is absolutely essential that a full list of questions submitted to the auditor should be made available to shareholders at the AGM. Other members of the working party believe that this is both impractical (because of the risk of abuse by activists) and unnecessary.

The working party agreed that before recommendations can be made, further work is needed on all of the areas noted above in the context of the current Companies Bill, the Combined Code, the DTI's work on the Company Law Review and its 1996 consultation on questioning of directors at AGMs.

The working party therefore recommends that the DTI should consider the implications of the Combined Code, the Company Law Review and the outcome of its 1996 consultation on the questioning of directors at AGMs in determining the way forward.

Background

The current position in the UK

The purpose of the AGM

The format of UK AGMs has changed over the years. They were originally designed when most companies had very few shareholders by comparison with the numbers many listed companies have today. Legislation and practice have evolved over the years but the main purpose of the AGM remains the same: to provide shareholders with an opportunity to exercise their rights which are to vote on the accounts, on the appointment or re-appointment of directors and auditors, and on other resolutions. In practice, this involves questioning and debate. But questioning and debate remain a means to an end, rather than ends in themselves. If shareholders do not consider the answers provided to them by directors and others are satisfactory, it is open to them to vote against the accounts and/or the appointment or re-appointment of directors and auditors.

Shareholders and their needs

UK shareholders do not form a homogeneous group. Some private shareholders attend AGMs and ask questions. Many institutional shareholders attend AGMs on a selective basis, partly because they invest in so many companies and partly because their needs are met in other ways (for example, by attendance at analysts' briefings and private meetings with company management). This means that fully meeting institutional shareholder needs may require changes that go beyond the scope of the AGM which is beyond the remit of the working party.

Questioning of auditors

Many auditors are represented at the AGM as a matter of course, even though there is no statutory or other requirement for them to attend. Some auditors' representatives also voluntarily answer questions at AGMs even though, again, there is no obligation to do so and despite the fact that any answers given are provided in the absence of a clear legal framework.

Questioning of directors

Questioning of directors at AGMs is commonplace, but there is no legal obligation for directors to attend. Directors only have a statutory right to speak on matters concerning their proposed removal. There is no statutory right of shareholders to ask questions. There are common law and other obligations which require directors to ensure that matters are properly debated.

The auditors' duty of care

Auditors owe a duty of care to shareholders as a body. Their audit report is addressed to all shareholders. Auditors do not owe a duty of care to individual shareholders. A statutory right of shareholders to put questions to auditors may potentially widen that duty of care to each shareholder asking a question. If the value of the spontaneous nature of the AGM is to be retained, some way must be found to preserve the current position. Otherwise, auditors will be reluctant, at very best, to respond to shareholder questions. Auditors should not be penalised for trying to be helpful. The same considerations apply to any written answers that auditors may choose to prepare.

The statutory and common law framework in the UK

The statutory and common law framework for questioning at AGMs is sparse. A summary is set out in Appendix 1.

Members have a common law right to speak at meetings. Common law, case law and the articles of companies generally require the chairman to impose reasonable limitations on this right, but chairmen must ensure that all business put before the meeting is conducted. In exercising their right to speak, members may ask questions of the chairman or other directors. But there is no statutory duty for the chairman, directors or others to answer any such questions, even though in practice they do.

The Companies Act 1985 gives auditors the right (but imposes no duty) to attend meetings and to be heard on matters that concern them as auditors (s390). It appears that some auditors already voluntarily answer questions at AGMs, but that there is no consensus on when this should happen, what sort of questions they should answer or on the legal status of those answers.

Directors have a statutory right to speak on a resolution to remove them (s304). Unless they are also shareholders they have no other statutory right to speak, although the articles usually give them the right to speak.

The 1996 DTI consultation

A 1996 consultation document issued by the DTI[1] asked whether shareholders experience difficulties in asking questions of directors at AGMs, and whether they should be given statutory rights to do so. The consultation appeared to concede that the matter should probably be left to best practice, not least because a right to ask questions would impose a duty on the chairman to provide time for all questions to be put which would be impossible within the time constraints of many AGMs. This view was reiterated within the Company Law Review (2000) and ICSA has produced guidance on the subject[2]. This guidance deals with the subject of advance notice of questions (i.e. written questions) but reminds interested parties of the spontaneity of the AGM, which ICSA regards as one of its 'greatest attributes'.

Some members of the working party consider that if legislation is required to compel auditors to attend AGMs, it would be anomalous if consideration were not given to requiring directors to attend AGMs. Similarly, if shareholders are to be provided with a statutory right to put questions to auditors at AGMs, it would seem anomalous to some

[1] *Shareholder Communications at the AGM*, 1996.
[2] *A Guide to Best Practice for Annual General Meetings*, ICSA September 1996.

working party members if such rights were not also extended in respect of directors, as is the case in Australia. Director attendance at AGMs is currently dealt with within the Combined Code.

The statutory framework in Australia

A summary of relevant Australian legislation is set out in Appendix 2. The auditors' duty of care and the associated legal framework in Australia are dealt with separately, below.

One misconception about the position in Australia is that auditors are required to *answer* questions at the AGM. This does not appear to be the case. Given that the Australian legislation empowers shareholders to ask questions though, it seems unlikely that auditors would refuse to do so point blank on a point of law. The statutory right of members to ask questions imposes a *de facto* if not a *de jure* obligation on auditors to at least try to try to respond subject to (in Australia) the control of questioning at AGMs by chairmen and the filtering of written questions by the auditor prior to the AGM. Chairmen in the past have been publicly criticised for not answering questions and auditors are unlikely to be treated in a different manner.

The thrust of the new Australian legislation is as follows:

> auditors of listed companies must attend AGMs. Shareholders may ask oral questions at AGMs on the conduct of the audit, the content of the audit report, accounting policies and auditor independence;

> members of listed companies may put written questions (no format specified) to auditors before AGMs via the company, but only on the conduct of the audit and the content of the audit report. Auditors decide on the relevance of these questions and pass a summarised list back to the company which must make the summarised list of questions available to members attending the AGM at or before the start of the AGM (no method specified). This gives members attending the meeting the opportunity to consider the issues raised;

> auditors are *not* required to answer written questions. But they must be permitted to do orally so at the AGM if they wish. If they have prepared any written answers the chairman at the AGM *may* permit the written answers to be tabled and must make them available to members as soon as practicable after the AGM; and

> the chairman at the AGM must allow a reasonable opportunity for members as a whole to ask questions or make comments on the management of the company.

The Australian legislation is new. The working party has endeavoured to find out how it has been operating in Australia to date by enquiring about the nature of questioning but the first reporting season in which the legislation has been effective has not yet passed. The working party has seen a few examples of auditor written responses to questions and notes that a substantial element of them might be described as boilerplate, or educational in nature which may be useful to some private shareholders, but probably not to institutional shareholders.

The working party cautions against the wholesale import of the Australian model before is has had time to bed in, and lessons are learned.

Detailed considerations

The needs of shareholders and the status of the AGM

Shareholders are not a homogeneous body. The concerns of private shareholders are not necessarily those of institutional shareholders.

What shareholders' needs are not being met?

Private shareholders

Most private shareholders ask sensible and important questions at AGMs. Whilst the questions posed by some private shareholders relating to detailed operational issues make AGMs a challenging task for some chairmen, particularly in the retail and utilities sectors (some companies have over one million shareholders on their registers), there is little doubt that some private shareholders place great value on the AGM as a forum for asking questions and for expressing concerns about the management and performance of a company, even if their questions are not, or cannot, be answered on the spot. Many companies go to great lengths to answer such detailed questions when they are put in writing to the appropriate level of management. Whilst there is also little doubt that some private shareholders feel that they do not get the answers they seek, the expectations of some such private shareholders may be unreasonably high, given the range of questions that are asked in practice. Furthermore, the types of question asked by private shareholders are normally most appropriately responded to by directors rather than the auditor as they frequently relate to the conduct of the business. Where questions are asked about audit issues, the answers that can be given often involve a response involving an explanation of the audit process, i.e. they are educational in nature.

Institutional shareholders

In practice, many institutional shareholders attend AGMs selectively. Their needs are met outside the AGM, for example at private meetings with management and at analysts' briefings. One member of the working party has suggested that consideration should be given to auditor attendance at preliminary announcements. Some institutional shareholders have indicated that in the vast majority of cases, their needs can be met by a dialogue with directors and only in exceptional cases would they seek to ask questions directly of auditors. They have also indicated that whilst they might in certain circumstances like to ask detailed technical questions on, for example, critical accounting policies, how auditors have arrived at their audit opinion in those areas, and on the rationale for and effect of changes in accounting policies, it is far more likely that their questions will be high level and relate to the audit as a whole. They recognise that:

> auditors are responsible for forming an opinion on the financial statements as a whole, and not on the constituent elements of the financial statements;

> auditors are responsible for forming an opinion on the financial statements for a given period and that they are not responsible for re-auditing prior periods;

> the AGM may not be an appropriate forum for dealing with highly complex technical issues; and

> the company, and in particular the audit committee, should always be the first port of call for questions on audit-related issues.

Other shareholder members of the working party have indicated that they feel strongly that questions to auditors on accounting policies are an important element of questions they would like to put to auditors. In this context, it is important to remember that if management is unwilling or unable to satisfy the needs of shareholders, it is unlikely that shareholders would be able to obtain the same information from the auditors, who have no right to communicate directly with shareholders and who are subject to a duty of confidentiality. If directors are unable or unwilling to provide information, they are highly unlikely to authorise auditors to provide that information. To waive statutorily the auditors' duty of confidentiality in this context could fundamentally alter the relationship of trust that is necessary for an effective audit to take place.

The only other circumstances in which auditors are permitted to communicate directly with shareholders without the 'permission' of directors is where they make a 'statement of circumstances' when they cease to hold office. Furthermore, to permit shareholders to put questions to auditors at AGMs without reference to the chairman would move control of the AGM from the chairman to shareholders, which would prevent the chairman from fulfilling his or her obligation to ensure that the business of the AGM is conducted properly, and would be unworkable in practice.

The new powers and duties of the Financial Reporting Council (including the FRRP and the AIU) greatly extend the scope for shareholder questions regarding critical accounting policies and there is already some interaction between shareholders and audit committees on accounting policies under the Combined Code. The statutory OFR is also likely to contain information on critical accounting policies (see below). Some members of the working party believe that these avenues should be explored further with regard to meeting the needs of institutional shareholders.

Shareholder members of the working party have however, indicated that they *would* like to ask high level questions about, for example, whether the auditors consider that they are sufficiently independent of the company to perform an adequate audit, and whether a new auditor considers that scope of the audit performed is adequate where a scope limitation qualification has recently been issued and where there has been a subsequent change in auditor. Whilst answers to such questions may be implicit in the fact of the auditors' appointment and the audit report itself (the auditors would not have accepted the audit had they not considered their independence and the scope of the audit to be adequate), shareholders would like to see auditors answer such questions 'in public', in the presence of shareholders, at the AGM.

The working party considers that the AGM is a valuable forum in which both private and institutional shareholders should be able to ask questions and express their views on the stewardship of the company.

The working party recommends that chairmen at AGMs should retain the right to determine how questions are dealt with at the AGM in order to preserve the orderly conduct of the AGM.

The scope of permissible questions and to whom questions should be addressed

There are four categories of permissible questions under the Australian legislation. These relate to the conduct of the audit, the audit report, accounting policies and auditor independence. While it seems clear that if questions of auditors are to be permitted, questions in the first two categories should probably be addressed by auditors, the second two categories are less clear. The directors are responsible for accounting policies and it would seem reasonable that questions on policies should, at least in the first instance, be directed to them. On the other hand, accounting policies can reasonably be seen as being included within the category 'conduct of the audit' and 'the conduct of the audit' can be interpreted very widely indeed. Auditor independence is the responsibility in the UK of both the company (specifically the audit committee) and the auditor. The new Combined Code requires audit committees to disclose how auditor objectivity and independence have been safeguarded. Guidance on the scope of questions has been produced in Australia by the professional bodies and firms of auditors.

The OFR and other forward-looking information

The Australian legislation does not deal directly with forward looking information, but it seems likely that the mandatory OFR will contain information on critical accounting policies, key performance indicators and resources and that shareholders, particularly institutional shareholders, will be interested in such information. Auditors do not and will not have a responsibility to audit the OFR or similar information in the annual report. Their responsibilities are likely to be limited to ensuring that information in the OFR and other information included in the annual report is consistent with the audited financial statements and that no matters have come to the auditors' attention in the performance of their duties as auditors which are inconsistent with information given in the OFR. Once again, directors have the primary responsibility for information in the OFR and other forward-looking information.

Some members of the working party consider that the scope of questions to auditors should be dealt with in some combination of legislation and best practice guidance and others consider that no such guidance is necessary as it would inhibit the questions that shareholders felt they were able to ask. In respect of accounting policies and auditor independence in particular, as noted above, it seems anomalous to some working party members that shareholders should be provided with a statutory right to put questions to auditors at AGMs if such rights were not also extended in respect of directors, as is the case in Australia.

Written questions

The working party considered in detail the issue of written questions, as this is an area in which shareholders have expressed a particular interest. In this context, it is important to recognise the purpose of written questions under the Australian legislation and the way in which they are dealt with.

The purpose of written questions

The purpose of the provision of written questions in advance of the AGM under the Australian legislation is to provide shareholders and directors with an understanding of the type of question that it likely to be asked at the AGM. The Australian legislation does *not* require the provision of written answers (although it deals with them if they are provided). It would be futile for legislation to purport to impose an obligation to answer, partly because of the potential volume of questions (particularly from those encouraged by activist groups who may be skilled in the use of electronic media to generate a flood of questions), but mostly because legislation cannot effectively provide as to the *quality* of answers.

Filtering

The Australian legislation requires *all* questions to be sent to the company, and for the company to send *all* questions to the auditors. The auditors then filter the questions for relevance to the questions permitted under the legislation, and for repetition; the auditors effectively summarise the questions asked. The summarised list is passed back to the company which makes the list available to shareholders at or before the beginning of the AGM.

Some shareholder members of the working party are concerned that filtering might result in questions that the auditors do not want to answer being filtered out. Other members of the working party believe that whilst in principle transparency would be better served if all questions were to be made available to shareholders at the AGM, the practicalities of this need to be dealt with in best practice guidance in order to avoid the possibility of an onerous burden being placed on companies were the system to be abused by activist groups. Furthermore, there is no *obligation* under the Australian legislation for shareholders to give advance notice of questions, or to restrict themselves at the AGM to questions of which notice has been given. And there is no obligation on directors to ensure that all questions are answered at AGMs (only to ensure that the business of the AGM is conducted fairly). The fact that the auditor had filtered out a question, or that directors had failed to take a question from a particular shareholder, would potentially enable the shareholder to make a decision about the integrity of both directors and auditors. The Australian legislation empowers shareholders to put questions, it does not (and probably cannot, for the reasons set out above) oblige auditors or directors to answer them.

Nevertheless, the working party believes that a statutory right to put questions in writing to the auditor, via the company, in advance of the AGM would provide a useful process whereby auditors would consider their position on the issues raised. It would also provide them with an incentive to attend to the meeting because of the implications for their reputation were they to fail to do so. This right should be accompanied by an obligation for directors to permit auditors to answer questions at the AGM.

The working party therefore recommends that shareholders be given a statutory right to put questions in writing to the auditor, via the company, in advance of the AGM.

The working party recommends that the provision to shareholders of a list of questions at the start of the AGM, should be dealt with in best practice guidance.

The auditors' duty of care

As noted above, there is no suggestion in the Australian model of any statutory duty for auditors to answer questions, although where questions are posed (either voluntarily or under statute) a *de facto* obligation to respond arises.

The *Caparo* case confirmed that the auditor owes a duty of care to the shareholders as a body, to enable them to exercise their class rights at the AGM, and not to individual shareholders. The introduction of a statutory right on the part of individual members to ask questions either before or at an AGM would potentially extend that duty of care. Given the 'spontaneous' nature of the AGM noted above, auditors may be vulnerable and they should not be penalised for trying to be helpful. Similar considerations apply to the provision of written answers to questions. It would be entirely counterproductive if the effect of any legislation were to reduce auditor responses to boilerplate because of unresolved liability issues. Lawyer members of the working party have expressed concerns about the use and effectiveness of oral disclaimers given by the auditor at an AGM or a written disclaimer issued with answers to shareholders' questions.

In Australia, auditor answers to questions are protected by a statutory defence of qualified privilege. Furthermore, in certain Australian territories, auditors are permitted to cap their liability to a specific monetary amount. In the UK, the defence of qualified privilege only applies to defamation claims and auditor liability cannot be capped.

The working party considers that in order for any legislation to be effective, the auditors' duty of care must not be extended beyond its current scope. Auditors' responses to questions put by shareholders under statute also need to be protected by a defence which must be wider in scope than the Australian statutory defence of qualified privilege. Any statutory defence needs to cover statements made by the auditor that might subsequently be construed as extraneous to the question raised.

In order for any legislation or best practice guidance to be effective, the auditors' duty of care, which is to shareholders as a body and not to individual shareholders, must not be extended beyond its current scope.

Other considerations

In addition to the many technical issues outlined in this paper, the following matters would also need to be addressed in the context of any legislation or best practice guidance:

> the precise definition of 'listed' company needs to be examined in the context of this proposal. The position with regard to listed or other companies that do not hold physical AGMs also needs addressing;

> no method for written questions (or answers) is prescribed in the Australian legislation: The background notes on the original Draft Bill indicate that this issue was discussed, including electronic written questions and answers, but it was decided that the matter would be left open.

> the time period permitted for the submission of electronic and written questions. There may be some precedent for this in other areas of law (the UK electronic communications legislation for example).

Appendix 1

UK Company Law

Auditors' rights to attend AGMs (s390 Companies Act 1985)

Auditors are entitled to receive all notices of, and other communications relating to, any general meeting of the company which a member of the company is entitled to receive. They are also entitled to attend any general meeting of the company and to be heard at any meeting they attend on any part of the business which concerns them as auditors. Auditors are *not* required to attend an AGM and are not required to speak to or answer any questions at the AGM (although in practice auditors do attend AGMs and may (at their discretion) answer questions put to them, by the chairman. Whilst s390(1)(c) provides that an auditor may speak on any matter that concerns him or her as auditor, there is no obligation to answer any question.

Shareholders' rights to ask questions at AGMs

The right of a shareholder to speak, and ask questions, at an AGM is a common law right. It is therefore capable of being modified by the company's articles. It is possible that the articles may restrict the rights of a member who is entitled to attend and vote at the meeting to speak although this would be unusual. The right to speak at an AGM is at the discretion of the chairman, who has a common law duty to ensure that all shades of opinion on a resolution before the meeting are given a fair hearing. Again, the chairman's rights may also be provided for and further prescribed in the company's articles.

Directors' duty to speak and answer questions at AGMs

Directors have a statutory right to speak on a resolution to remove them as directors (s304). But apart from this, unless directors are also members, there is no statutory right for them to speak at the AGM and hence no obligation to answer any question. So whilst shareholders may ask questions (and indeed the chairman must allow debate) they have no right to receive an answer. The company's articles do usually give directors who are not members the right to speak. However, neither the chairman nor the directors have a legal obligation to respond to questions put to them by shareholders at an AGM. And where the company's articles are silent on this, it is possible that the meeting may refuse to allow the directors to speak. When answering questions, directors of listed companies are constrained by the requirements of the Listing Rules on the release of unpublished price-sensitive information. The 1996 DTI consultation on the questioning of directors recognised that giving shareholders a statutory right to ask questions would make it impossible for the chairman to curtail debate until all members had asked their questions. The provisions of the Combined Code deal with the duties of chairmen and directors in this area.

Qualified privilege

Certain statements made in particular circumstances, such as words published in the discharge of a public duty, may be privileged on public policy grounds. If auditors were to be subject to statutory provisions obliging them to attend AGMs, they would fulfil a statutory duty in so doing, although an AGM is a private meeting. Qualified privilege confers limited protection (providing there is no malice, the author is acting in good faith and without improper motive) and may be a defence to a proceeding for defamation. The defence may be available to the auditor if the company were to bring an action in defamation. It is unlikely that a shareholder would have cause to bring a claim against an auditor for defamation.

Appendix 2

Australian company law

The legislation referred to throughout this appendix is the Australian Corporations Act 2001. The relevant sections can be accessed through
http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/

Contravention of any of the sections referred to below is an offence of *strict liability* which has implications for lead auditors, chairs at AGMs and others. Qualified privilege applies to all auditor answers referred to below.

Background

Members of Australian companies have been entitled ask question of auditors regarding the conduct of the audit and the content of the audit report at AGMs since 1998. But until the CLERP 9 proposals were enacted as of 30 June 2004, auditors were not required to attend AGMs and only members attending AGMs could ask questions. Most of the new legislation only applies to the auditors of listed companies. The position for unlisted companies remains effectively the same as before, i.e. auditors are not required to attend AGMs, but if they do so they must answer questions. The new legislation is effective for accounting periods beginning on or after 30 June 2004. As such, there has been very little experience to date of its application.

Requirement of auditors to attend AGMs – listed companies

Section 250RA requires auditors of listed companies to attend AGMs at which annual audit reports are considered.

Individual auditors can 'arrange to be represented' by suitably qualified members of the audit team who are in a position to answer questions about the audit.

Firm or company auditors must send the 'lead auditor' or a suitably qualified member of the audit ream in a position to answer questions. The responsibility is that of the individual or 'lead auditor'.

The slight difference in responsibility appears to reflect the fact that individual auditors may make appropriate arrangements which go wrong, whereas firms should not find themselves in this position (although it seems unlikely that there will be many 'individual auditors' appointed to listed companies).

Questions by members of auditors at AGMs – all companies

Section 250T requires that *if* the auditor or his/her representative is present at an AGM, the chair must allow a 'reasonable opportunity' for members 'as a whole' to ask auditors questions relevant to the conduct of the audit, the preparation and content of the audit report, the accounting policies adopted by the company in the financial statements, and the independence of the auditor in relation to the audit.

Chairs *must* also permit auditors or their representatives to make oral answers to written questions (see below).

Chairs *may* also permit auditors or their representatives to table written answers to any written questions (see below) and make those answers 'reasonably available' to members as soon as practicable after the AGM (but only if the auditor or his/her representative is present at the AGM). No method is specified.

Written questions – listed companies

Section 250PA states that written questions to auditors on the content of the auditors' report and the conduct of the audit (only – the list is shorter than the permissible questions that can be put orally at the AGM – see above) can be submitted to the company. Again, no method is specified.

They must be submitted no later than the fifth business day before the AGM. The company must then pass the question to the auditor 'as soon as practicable' after receipt regardless of whether the company thinks it relevant.

The auditor (individual auditor, lead auditor or their representatives) must then summarise and provide to the company a list of relevant questions. They can filter out duplicated questions (even if expressed differently) and questions not relevant to the content of the audit report and the conduct of the audit. This must be done 'as soon as practicable after the end of the submission time and a reasonable time before the AGM'. Given that the submission time is five days before the AGM this is not long, however, a question does not need to be included if it is not practicable to include it, or to decide whether to include it, because of the time when the question was passed to the auditor.

The company must make copies of the list of questions provided by the auditor 'reasonably available' to members attending the AGM at or before the start of the AGM. There appears to be no requirement to make any written questions available to members other than those attending the AGM (although any written answers must be, see above).

Observations and comments by members on company management

Section 250S states that the chair of an AGM must allow a reasonable opportunity for the members as a whole at the meeting to ask questions about or make comments on the management of the company (such a right does not exist in UK law).

Appendix 3

Working party

We are grateful to the following people for their input to this policy proposal issued to the *Audit Quality Forum*. Their input does not necessarily reflect the views of the organisations they work for or are attached to.

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