Agenda Item 8(b).1
AUASB Meeting 1 December 2015
As received on 16/11/2015

Clarifying the purpose of audit opinions

Following the decision of the UK Courts in the case of *Royal Bank of Scotland v Bannerman Johnstone Maclay*, the ICAEW developed and released wording for inclusion in auditors' opinions to address the issue of third party reliance on audit reports (see Technical Release 01/03). The standard wording has been updated and amended from time to time, most recently in 2010. The wording is commonly referred to as a "Bannerman clause".

As explained in the relevant ICAEW guidance, the concern which gave rise to the perceived need for action was that "sometimes a duty of care to a third party might be assumed inadvertently as a result of action or inaction by the auditors".

The Bannerman clause is intended to make clear that the auditors' opinion is provided for the benefit of the members of the company as a body as required by legislation and not for other purposes or for the use of third parties. It seeks to clarify that the auditor has not prepared the opinion to inform matters such as decisions by financiers as to the creditworthiness of the company or decisions by potential investors in the company as to whether the company's shares are a good investment.

The risk which the wording is intended to address is claims being made against the auditor by parties who purport to have relied on the auditor's report in making such decisions.

In the recent case of *Barclays Bank plc v Grant Thornton* the UK Courts have held that a Bannerman clause is effective in preventing an auditor from being liable to a bank which purportedly relied on audited accounts in making decisions in relation to finance facilities of the audited entity.

The leading authority in Australian on the limits of an auditor's liability is the 1997 decision of the High Court of Australia in *Esanda Finance Corporation v Peat Markwick Hungerfords*. In that case the High Court held that to place an auditor under a duty of care to a financier (at least in the circumstances of that case) would leave the auditor with potentially indeterminate liability to an indeterminate class of claimants and would therefore be contrary to public policy.

In consultation with CAANZ, PWC, KPMG, Deloitte and EY, consideration was given to the potential for use of a Bannerman type clause in Australia in light of the decision in the Grant Thornton case in the UK. Each of those organisations consider that it would be in the best interests of the auditing profession generally for the Board to publish a standard form of wording that could be used in Australian statutory audit opinions to the same effect as the Bannerman clause in the UK. The inclusion of the wording would not be mandatory.

The proposed wording (based on the current ICAEW template and showing marked up changes to the UK wording) is attached, together with a clean version of the wording. The changes proposed would be necessary for the Australian context in order to reflect local legislation and clarify the intended meaning of the clause.

In Australia, in order to overcome the limitations on the auditor's duty of care to third parties, claimants have attempted to bring claims on the basis that the auditor's opinion constitutes a misleading representation of certain matters and that they have relied upon that representation in taking various actions, giving rise to a claim against the auditor for loss or damage. Wording has been included at the end of the paragraph to address this specific risk.

The paragraph would be placed under a heading "Purpose of this report" at the end of the audit opinion immediately above where the auditor signs.

In effect the proposed wording does no more than summarise and clarify the current law in Australia. It would help clarify for readers the purpose of and limitations upon the audit opinion.

The above has been prepared in consultation with CAANZ, PwC, KPMG, EY and Deloitte. It does not constitute legal advice and independent consideration should be given to the proposed changes.

12 November 2015