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14 October 2010

Dear Ms Spargo,

**Exposure Draft 02/10 APES 230 Financial Advisory Services**

We refer to the Exposure Draft 02/10 APES 230 Financial Advisory Services (the “ED”) and the Accounting Professional and Ethical Standards Board (the “APESB”) request for comments thereon.

As a general comment, we fully support the APESB in its intention to promote proper behaviour by members of professional accounting bodies, when acting as financial planners. Also, given the potentially far reaching implications of the ED, we appreciate the opportunity to comment on it, particularly given we are of the strong view that there are important issues that require further consideration.

For completeness, in section 4 below we note a number of matters that arise from the ED where we do not perceive a significant direct impact on this firm, but recognise a potential impact on the wider accounting profession.

**1 Definition of “Financial Advice” in the ED**

1.1 Our first concern is with the service range covered by the ED. We note that in announcing the proposed new standard, you referred to the standard as applying to financial planners. However, our reading of the ED is that it has application to a much wider range of practitioners than accountants acting as financial planners. In our view, the present definition of “financial advice” is far too wide. It has the effect of applying to many situations where ordinary tax and accounting advice might be required by a taxpayer client, but where it could not be said that the accountant is providing “financial planning” services. For example, the proposed standard appears to apply to an accountant advising on matters as diverse as:

- the accounting and taxation issues inherent in structuring of a complex group of family-controlled companies, where the founder is considering retirement and passing control of the group to the next family generation

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- the application of the dividend franking system to receipt of dividend income from shares that a client has already purchased
  - the applicable tax depreciation rate to apply to a residential property, for a client proposing to acquire such a property as an investment, and
  - the value of the shares of a family company sought by a controlling shareholder who is considering his estate planning options.
- 1.2 Many more examples could be provided to demonstrate how ordinary professional accounting activities are drawn into the ambit of a proposed standard intended to apply to financial planners. In each of the above mentioned examples, the accountant would not normally be acting as financial planner. We are not aware of any professional or ethical reason to impose further regulation on such activities. Importantly, for the reasons noted below, it could not be said that the advisor relationship ordinarily constituted a “fiduciary relationship” as anticipated in the ED.
- 1.3 We note our concerns with the definition do not arise from a preference to receive fees other than on a fee for service basis. The real issue is that the ordinary interaction with our clients, which is already governed by a range of other professional pronouncements, may be dramatically affected. For example, the requirements of paragraph 7.8 in the ED would mean that a simple telephone enquiry about a depreciation rate on an investment property would necessitate a detailed written report in the prescribed form.
- 1.4 In our view, the definition of “Financial Advice” within the ED should be amended to make it clear that tax and accounting services, where the accountant is not otherwise providing financial planning services, are expressly excluded. We appreciate that this may be easier in concept than it is to draft. Perhaps the APESB may consider:
- limiting the definition to services for which an Australian Financial Services Licence is required. We appreciate that this has the effect of narrowing the application of the standard, but it is still likely to continue to address the majority of APESB’s fundamental reasons for developing a standard.
  - providing specific exclusions. For example, exclude “services where both an Australian Financial Services Licence is not necessary and the principal requirement is the application of tax or accounting expertise.”
  - in addition to the above suggestions, limiting the definition to retail clients thus excluding wholesale clients.

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## 2 Fiduciary Relationship

2.1 The ED asserts that:

*“where a Member provides a Financial Advisory Service, a Fiduciary Relationship will exist between the Member and the Client”<sup>1</sup>.*

2.2 This is the first APESB pronouncement to refer to accountants being in a fiduciary relationship in any context, and we are not aware of any predecessor pronouncement that asserts the existence of such a relationship. We understand that the suggestion is based on Government statements concerning proposed legislative reform of the financial planning industry but the Government itself has acknowledged that more work needs to be done in order to fully articulate the scope and content of the duty. As such, it very much remains work-in-progress.

2.3 It is most unusual for legislation to impose or create a fiduciary duty and relationship (that is inherently common law) between parties. Whether this is appropriate at all will be the subject of detailed submissions to the Federal Government and, we expect, considerable debate in relation to the proposed legislation.

2.4 We are of the strong view that for the standard to assert a fiduciary relationship ahead of the legislation invokes uncertainty as to whether the huge body of law relating to fiduciaries applies to accountants (for example, the so-called “no profit rule” where a fiduciary may not profit from its fiduciary position without the beneficiary’s consent). It also muddies the waters as to how remedies for breaches of duty would apply (for example, account of profits, compensatory damages etc). This is against the backdrop of courts being reluctant to impose fiduciary duties on accountants at all unless the context specifically dictates otherwise<sup>2</sup>. If, however, the duty is ultimately codified within legislation, we would expect it to provide an opportunity to limit the scope of the fiduciary relationship and clarify the consequences of a breach.

2.5 We note also that members may need to examine their insurance arrangements to determine whether they hold cover (or sufficient cover, as the case may be) for a breach of a fiduciary relationship, given the focus to date has been on professional negligence. The proposed fiduciary duty is significant for accountants and their insurers because:

- the amounts awarded for breach of fiduciary obligations may be greater given fiduciary obligations “are more onerous (and the legal consequences more drastic) than those arising from common law duties of care or from contractual relationships”<sup>3</sup>
- the limitation period is longer

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<sup>1</sup> Para 4.1 of the ED.

<sup>2</sup> For example, *Prince Jefri Bolkiah v KPMG (A Firm)* [1998] UKHL 52; [1999] 2 WLR 215.

<sup>3</sup> *Pilmer v The Duke Group Limited (in liq)* [2001] HCA 31 (31 May 2001) Kirby J at para 123.

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- it is possible that notions of contributory negligence do not apply <sup>4</sup>.

2.6 We strongly believe it is not appropriate for such complex relationships to be sought to be imposed or created at the standard level. The potential for unintended consequences of introducing this concept into a standard is too high, and there appears little need to refer to it in order to achieve the objectives of the standard.

### 3 Proposed effective date of the ED

3.1 We note that the financial planning industry is currently subject to proposed reforms that have been announced by the Australian Federal Government. We understand that the ED is intended (at least in part) to reflect those anticipated reforms, although in our view the APESB is quite properly seeking to ensure that accountants act professionally and ethically regardless of any legislative regime. The proposed legislative changes are to apply from 1 July 2012. However, the ED is proposed to apply as a standard from 1 July 2011.

3.2 In our view, for the reasons already set out above, it is not desirable for the draft ED to proceed before the legislative reforms have been finalised and become law. Our main concern is that the proposed standard and legislation would not be aligned, causing confusion and complexity in this already challenging area.

3.3 Given the above, we agree with media release by the Institute of Chartered Accountants dated 1 July 2010 urging the APESB to set a pragmatic and appropriate timeframe for implementation of the proposed new standard. We suggest that the ED should remain as a draft, or perhaps be issued only as guidance, until after the legislation is passed.

### 4 Other matters

4.1 It appears that the requirements in the ED may give rise to a number of consequences that require further consideration. For example, we note that:

- it appears that accountants providing services related to insurance would not be able to accept income according to the long standing practices of that industry. Is it APESB's intention to change the usual practices of the insurance industry in the same way as the announced intent to regulate accountants in financial planning?
- it also appears that members in business, who are employees (for example) of large organisations providing financial planning services, may be placed in the position where they are subject to a standard which they cannot comply with if they remain in their present employment. This might be a particular problem if the ED becomes a standard before any relevant government legislation. We assume it is not APESB's

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<sup>4</sup> Noted by the majority in the above mentioned case.

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intention to cause such members to either resign from their employment or renounce their membership of a professional accounting body.

- Paragraph 7.1 of the ED appears to impose a requirement for work to be done that may be in excess of what a client requests. We again assume it is not the APESB's intention to impose on clients the requirement to pay for advice the client does not want, and may not need.

We trust you find these comments helpful and should you wish to discuss any aspect of the above in further detail or require any further information, please do not hesitate to contact me.

Yours sincerely



Paul Carter  
Partner