APESB

Accounting Professional & Ethical Standards Board

Annual Review of APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document*

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1. Executive Summary

1.1. Background

Accounting Professional and Ethical Standards Board (APESB) issued a revised APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document* (the Standard) in March 2011. The new Standard includes additional considerations for Members providing a Due Diligence Sign-Off as well as an added template for a Materiality Letter.

1.2. Reason for this report

In accordance with the constitution of the APESB, an annual review needs to be performed on each professional standard. This report presents a review of the issues reported to the APESB and proposed recommendations to address the identified issues.

1.3. Issues identified

The key concerns raised by stakeholders are summarised below (also refer to Appendix 1).

Previous Issues

The previous issues noted by the stakeholder were addressed in the Basis for Conclusions for APES 350 and the 2011 Review of APES 350.

"Low doc" Issue

The stakeholder has also raised an issue in respect of what they perceive as accounting firms reluctance to provide an APES 350 sign-off in connection with "low doc" offers. They are of the view that if an accounting firm performs a review mandate or Agreed Upon Procedures mandate that it would be appropriate to provide an APES 350 sign-off with adaptation of language to different legislative context on the work they have performed.

2. Review of Issues

The APES 350 Taskforce discussed the "Low Doc" issue and the Taskforce Members present were unanimous that there have been no practical issues experienced with APES 350 on "low doc" engagements. The example raised by the external stakeholder related to an engagement where the Firm had clearly stated from the outset that it was not in a position to provide an APES 350 sign-off. Further, it was noted by the Taskforce that there were a range of other factors relating to this transaction which had not been included in the external stakeholder's submission. The Taskforce was provided with further details, within confidentiality constraints, to understand how APES 350 had been applied and was satisfied that the standard in its current form was equipped to deal with such situations.

APES 350 requires a Member in Public Practice to consider whether the scope of procedures undertaken is sufficient and appropriate to support the provision of an APES 350 Due Diligence Sign-off. Whether the Member in Public Practice can provide an APES 350 Due Diligence Sign-off will depend on matters such as the scope and nature of procedures undertaken, the time available and the depth of the due diligence process. The decision to provide, or not provide, an APES 350 Due Diligence sign-off needs to be determined on a case by case basis and APES 350 currently has this flexibility.

Contrary to the stakeholder contention that Firms are not generally providing APES 350 sign-offs, representatives of the Firms have stated that there have been numerous instances in the past year where APES 350 sign-offs have been given in respect of "low doc" issues. These are circumstances where the scope was appropriate and there was sufficient work performed to enable the Member in Public Practice to provide an APES 350 sign-off.

Impacted Stakeholders

Clients, Members in Public Practice, Firms and professional accounting bodies

Recommendation

The existing paragraph 1.9 of APES 350 allows a Member in Public Practice to apply the standard to the extent practicable in the case of "low doc" offers. Accordingly no further amendments to the existing APES 350 are proposed.

APPENDIX 1 –Comments from Mr C. Andrade at Baker & McKenzie

From: Andrade, Craig [mailto:Craig.Andrade@bakermckenzie.com]
Sent: Monday, 2 April 2012 6:21 PM
To: channa.wijesinghe@apesb.org.au
Subject: APES 350 - 12 month review

Dear Channa

Thank you for providing us with an opportunity to comment on APES 350 as part of the annual review of the standard.

As we have noted in our prior correspondence with the APES Board in relation to both the development of APES 350 and the subsequent 6-month review of the standard, there are several areas where we, and various other law firms and AFMA members with whom we have consulted, disagree with the approach that has been taken. We continue to hold those views and believe that APES 350 could do more to meet the needs of the issuer client and the other legal and financial advisers who participate in equity capital raisings.

So in addition to those previously noted matters that we continue to disagree on, we note that there is a key area in which APES 350 is simply not being used as it was originally intended and is largely being ignored by accounting firms. This is the application of APES 350 to "low doc" rights issues. It is fair to say that over the last few years rights issues now tend to generally be conducted in the Australian market by way of the "low doc" (ie cleansing notice) regime, not through the issue of a prospectus.

We are aware of several instances where accounting firms have refused to provide APES 350 sign-offs on the basis that:

1 The offer materials (which typically comprise an ASX announcement, investor presentation, cleansing notice and offer booklet) are not a prospectus. The Corporations Act permits this form of disclosure for secondary offers. Yet most accounting firms seem to regard anything less than a prospectus as somehow warranting a position of "no APES 350 sign-off". This is despite the fact that:

- APES 350 expressly permits an APES 350 sign-off to be given in these circumstances; and
- legal opinions are always given in "low doc" rights issues and those opinions cover *the offer documents* as well as *due diligence enquiries*.

2 The scope of work and time permitted are insufficient to permit an APES 350 sign-off to be given. Clearly a key issue for an accounting firm should always be to ensure that its agreed scope of work can be performed within the time frame of the relevant transaction. We also understand that a scope of work may vary from providing a materiality guidance letter, to performing some agreed upon procedures in relation to ratio calculations through to reviewing a pro forma balance sheet and reviewing historicals and forecasts. Time frames can also vary

from a couple of weeks to several months. However, in one instance where an accounting firm had been engaged for a 3 month period prior to launch to perform:

- a review of a pro forma balance sheet that was included in the investor presentation;
- detailed agreed upon procedures in relation to the issuer's business model;
- a review of certain forward looking financial information that was included in the investor presentation;

the accounting firm refused to issue an APES 350 sign-off and instead issued a "private report" which was a significantly cut down version of an APES 350 sign-off. Some of the key issues with the approach taken by the accounting firm were:

- its refusal to give negative assurance around the reasonableness of the due diligence enquiries in relation to the "Financial Information" (which was defined narrowly with reference to the pro forma financial information that the accounting firm had reviewed and which was included in the investor presentation);
- its refusal to acknowledge that it has read the entire investor presentation.

It is relatively standard practice for an issuer's legal counsel in a low doc offer to give negative assurance that:

- the offer documents (which are usually defined to cover the cleansing notice, investor presentation, rights offer booklet and ASX announcement) are not false, misleading or deceptive (including by omission); and
- the due diligence process (as described in the Due Diligence Process Outline ("DDPO", which is the equivalent of the Due Diligence Planning Memorandum for offers under a prospectus):
    - constitutes the taking of reasonable steps and making reasonable enquiries to assist in ensuring that:
        - the Cleansing Notice meets the disclosure standard; and
        - the Offer Documents are not false, misleading or deceptive (including by omission); and
    - has been conducted in accordance with the DDPO.

The accounting firm's refusal to give an APES 350 sign-off in the circumstances described above was extraordinary in light of the scope of the review work and agreed upon procedures it agreed to perform over the three month period. As noted above, given that:

- the market for rights issues is largely characterised by low doc offers, not offers made under a prospectus;
- issuer's counsel opinions in low doc offers addressing both the quality of the disclosures in the Offer Documents and the reasonableness of the due diligence enquiries set out in the DDPO;

- the current strong refusal by accounting firms to adhere to the letter of APES 350 and issue an APES 350 sign-off in circumstances where the scope of work does comprise assurance engagements in accordance with the review standards, and there is sufficient time for that work to be done, is counterproductive to the efficient functioning of Australia's capital markets and makes a mockery of the APES 350 standard.

What is probably required is further guidance on the application of the APES 350 standard to low doc offers since the softer approach currently reflected in the standard leaves this entirely in the hands of the accounting firms and their subjective judgement. And as the evidence would tend to suggest, that judgement has almost without fail been to ignore APES 350 and refuse to provide a sign-off in the agreed form. Despite the disagreement we may have over the form and content of APES 350, for this standard to have relevance in Australian capital markets it needs to be applied to clearly articulated principles that extend to low doc offers.

Regards

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