

AGENDA PAPER

Item Number: 10.1
Date of Meeting: 7 September 2009
Subject: APES 350 ED *Participation by a Member in Public Practice in Due Diligence Committees*

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Purpose

To provide an update to the Board on the progress of the project and to table the analysis of the respondents comments to the Exposure Draft.

Background

The Financial Reporting Council (FRC) informed the APESB of the need to develop a professional & ethical standard in respect of Due Diligence Committees in May 2008. At the time APESB was developing APES 345 ED *Reporting on Prospective Financial Information prepared in connection with a Disclosure Document* which referred to Due Diligence Committees. Based on feedback received on APES 345 ED in July 2008, the Board recognised the need for a comprehensive pronouncement in this area of practice for professional accountants. Accordingly, the Board instructed technical staff to prepare a project proposal to develop a proposed pronouncement on the involvement of Members in Public Practice in Due Diligence Committees. Subsequently, in October 2008 the Board approved the creation of a taskforce to develop APES 350 ED.

The APES 350 Due Diligence Committees taskforce prepared an exposure draft which was released for public comment in May 2009. APESB received eight submissions from firms, professional bodies, and the Australian Financial Markets Association (AFMA).

Consideration of Issues

The key issues raised by respondents are:

- The role of the observer in Due Diligence Committees (Issues 9,10,18 and 52);
- Independence Requirements (Issues 11-13, 15,16 and 19-20);
- Engagement Document versus Due Diligence Planning Memorandum (Issues 29,30,70, and 71);
- A Member in Public Practice's legal obligation of disclosure (Issues 38,39, 41,78, and 83)
- Verification obligations of a Member in Public Practice (Issues 46 and 47)

The role of the observer in Due Diligence Committees

Some of the respondents noted that APES 350 ED is not clear in the way it describes the role of the DDC Observer. The respondents noted that it is not an uncommon practice for Members in Public Practice to undertake engagements as a DDC Observer in a due diligence process. In terms of articulating the distinction between the two roles, the key distinction is that the DDC Observer role does not involve having the responsibilities of a DDC Member, which include being satisfied, having relied on the other members of the DDC in relation to matters outside the accountant's area of expertise, with the overall appropriateness of the due diligence process and public document content. Consequently, unlike a DDC Member, a DDC Observer does not sign the joint report of the Due Diligence Committee confirming the overall appropriateness of the due diligence process and public document content.

Respondents have recommended the proposed standard should provide clarity on the three roles of DDC Member, DDC Observer and Reporting Person. The taskforce is in the process of redrafting the proposed standard taking into consideration these comments.

Independence requirements

Respondents have noted that independence is a key issue that requires consideration prior to accepting an appointment to undertake a role which includes participating in and/or reporting to a Due Diligence Committee. One of the key threats is the accountant may be deemed to be performing a management function. The professional bodies have proposed a recommendation to address this threat.

Engagement letter versus Due Diligence Planning Memorandum

Some of the respondents noted that the requirements of APES 350 ED imply that a member should decline the engagement where additional responsibilities come up at a later date which were unforeseen when the Engagement Document was signed. Some respondents noted that additional responsibilities may be described in the Due Diligence Planning Memorandum or minutes of the Due Diligence Committee and that the standard should not preclude the Member in Public Practice from carrying out these additional tasks.

In accordance with APES 305 Terms of Engagement, the fundamental principle is for a Member in Public Practice to document and communicate the terms of engagement with the Client. These professional obligations cannot be driven by documents that the Member in Public Practice does not control.

In order to remove ambiguity, amendments have been made to section 4 of the proposed APES 350. These amendments clarify that the Member may issue addenda to the original engagement letter to accommodate additional tasks that may come up later in the due diligence process.

A Member in Public Practice's legal obligation of disclosure

AFMA in their submission note that a Member in Public Practice who advises on, or provides content for, a Public Document must ensure that their contribution meets the relevant disclosure standard imposed by law. AFMA states that it is entirely appropriate that a Member in Public Practice confirm to its Client and the DDC that their advice on, or content provided for, a Public Document meets the relevant disclosure standard imposed by law. According to the respondent, a failure by a Member in Public Practice to provide an express confirmation in relation to its own work product will mean that others involved in the preparation of a Public Document potentially have inadequate assurance that the accountant's work product complies with the disclosure standard. AFMA contends that the effect of this failure by a Member in Public Practice to provide an express confirmation in relation to its own work product is to transfer risk on the issue of compliance of an accountant's work product to others involved in the preparation of the Public Document.

The APES 350 Taskforce does not agree with the respondent and has noted that:

- underpinning AFMA's submission is the assumption that the Member should have responsibility for advising and signing off on all of the financial, accounting and/or tax information in the public document, and not just the particular financial, accounting or tax information the Member has performed procedures on. AFMA's comment that a Member should ensure that its "contribution" meets the relevant disclosure standard imposed by law therefore amounts to a sign off that the public document is not defective (and that proper due diligence enquiries have been made in relation to it) so far as all information of a financial, accounting and/or tax nature is concerned;
- the decision as to what information is to be disclosed in the public document is a decision for the client;
- in practice, the client makes this decision following input from its financial adviser (investment bank) and lawyers as well as the Member in Public Practice, but the decision as to what should be disclosed is never made by the Member in Public Practice;
- there is no framework for determining what are appropriate or adequate financial disclosures in a public document and consequently the quantum and nature of financial information disclosed in public documents can vary significantly;
- the dual purpose of the public document, in being both a marketing document and a compliance document, means that it will never be the Member in Public Practice who determines the content of the public document. This situation is different in comparison to the annual financial reporting process. In the case of the annual financial report, a client prepares the financial report in accordance with an established disclosure framework set out in the accounting standards.

For these reasons the taskforce's view is that the responsibility for signing off on whether the financial information disclosed is appropriate and adequate to meet the relevant disclosure standard should not rest with the Member in Public Practice alone. It should be provided in the collective DDC signoff rather than the individual Member's signoff. A Member in Public Practice who is a DDC member provides this signoff by signing, along with the other members of the DDC, the collective signoff on the content of the public document as a whole.

If the respondent's position is to be adopted then a framework will need to be established to identify what financial disclosures are required to meet the S710 general disclosure test, however, this is outside the scope of the taskforce and indeed it is outside the APESB's mandate. It would need to be legislated as it is in other jurisdictions. The Member in Public Practice could then assess the financial information going into a public document for disclosure to an investor against the established framework.

Adoption of the respondent's position without an established framework could significantly increase the costs of these engagements, and the costs of preparing public documents, as the Member in Public Practice may determine that in order to provide such a sign-off it would need disclosures similar to those in an annual financial report, since they have been legislated to be the required disclosures to be made by a public company to its investors.

Further, the respondent does not appear to appreciate that in any assurance engagement the primary responsibility for the Client's information rests with the Client, as it is the Client's information and not the Member's. Further, based on discussions with the respondent there is no legal precedent in Australia that supports the respondent's position or view.

Finally, if the respondents' interpretation of the law is correct then that interpretation will prevail as all APESB Standards are subject to the law. However, as noted in the recommendations, APESB should obtain independent legal advice prior to the issue of APES 350 that the proposed standard does not contravene or provide a constructive barrier for the Issuer's compliance with the *Corporations Act 2001*.

Verification Obligations of a Member in Public Practice

Respondents have noted that the prohibition on verification in APES 350 ED may not be appropriate. This is due to the practice of Members in Public Practice carrying out agreed upon procedures engagements to assist Clients with their verification procedures and in certain instances assisting in drafting parts of the public document (For example, tax impacts for an investor). Appropriate amendments have been made to address these comments. However, it should be noted that the primary responsibility for verification rests with the Client as it is the Client's information.

Staff Recommendations

- The Board consider the respondents comments and provide review comments on the approach taken by the taskforce to address issues raised by respondents to the exposure draft.
- Based on feedback and editorials from the Board, the taskforce will continue to work on the proposed standard with view to presenting it at the November 2009 Board Meeting for final approval.
- The Board obtain independent legal advice whether the proposed standard contravenes the *Corporations Act 2001*.

Material Presented

- Working draft of proposed Standard (in marked up mode) APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document*;
- Working draft of proposed Standard (in clean mode) APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document*;
- General comments table;
- Specific comments table;
- Minutes of Taskforce meetings;

Authors: Channa Wijesinghe
Roshana Nanyakkara

Date: 31 August 2009