

AGENDA PAPER

Item Number: 10.3
Date of Meeting: 7th September 2009
Subject: APES 330 *Insolvency Services*

Action Required

For Information Only

Purpose

To obtain Board approval to issue the proposed Standard APES 330 *Insolvency Services* to replace the existing professional statement APS 7 *Statement of Insolvency Standards*.

Background

The existing professional standard APS7 *Statement of Insolvency Standards* was issued in March 1998. The Insolvency Practitioners Association of Australia (IPA) developed a *Code of Professional Practice for Insolvency Professionals* which was issued in May 2008. Given that some members of the professional accounting bodies are also members of the IPA, it is imperative that ethical standards issued by APESB are broadly consistent with the requirements of IPA.

The Board approved the creation of the APES 330 Insolvency Services taskforce in February 2008 to develop APES 330 with a view to replacing APS 7. The Insolvency Services taskforce prepared an exposure draft which was released for public comment in December 2008. APESB received five submissions from professional bodies, IPA, firms and the corporate regulator. These submissions along with the APESB technical staff comments were presented to the Board at the May 2009 Board meeting. The Board considered the issues raised by respondents in terms of independence, expert witnesses, professional fees and other matters. A revised version which incorporated the Board's review comments was presented to the Board on the 22nd of July 2009. The significant remaining issue after the July Board meeting is the issue of the independence of a Member in Public Practice which is considered in Appendix 1.

Consideration of Issues

Some of the respondents to the ED have raised concerns with the APESB over the definition of Independence and whether it can be read to be a subjective test. They believe that Independence is critical to a Member in Public Practice who undertakes Insolvency Services and that the Code's definition of independence needs to be amended.

The issues raised have been further analysed in the attached *Appendix 1: Independence of a Member in Public Practice who provides Insolvency Services*.

Staff Recommendation

Subject to the Board's review comments and editorials, the Board approve the issue of APES 330 *Insolvency Services*.

Material Presented

- Proposed marked up version of APES 330 *Insolvency Services*;
- Proposed clean version of APES 330 *Insolvency Services*;
- Basis for conclusion;
- Respondents comments (Confidential)

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Date: 27 August 2009

Appendix 1: Independence of a Member in Public Practice who provides Insolvency Services

Consistent with APES 110 *Code of Ethics for Professional Accountants* (the Code), APES 330 defines Independence as:

Independence means

- (a) Independence of mind - the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional scepticism; and
- (b) Independence in appearance - the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a Firm's, or a member of the Engagement team's, integrity, objectivity or professional scepticism had been compromised.

The respondents who are concerned about the above definition are of the view that Independence is not a state of mind and, in fact, the subjective state of mind of the Member in Public Practice is irrelevant. They also note that a Member in Public Practice who provides Insolvency Services must be, and be seen to be, Independent at all times in the performance of their duties and functions when accepting and conducting an Appointment.

The respondents propose that the above definition needs to be amended and an overarching principle needs to be included in APES 330 in the following manner:

Suggestion 1 Definition of independence

"**Independence** means:

- a) Independence ~~of mind in fact – the state of mind that~~ **where the facts and circumstances** permits the provision of an opinion without being effected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism; and
- b) Independence of appearance – the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all the relevant information, including any safeguards applied, would reasonably conclude a Firm's, or a member of the engagement team's, integrity, objectivity or professional scepticism had been compromised-; **including conflicts between that person's interest and an extraneous interest.**"

Suggestion 2 Inclusion of an overarching principle

Insert as a new paragraph 4.1

"A Member in Public Practice who provides Insolvency Services must be, and be seen to be, Independent at all times in the performance of their duties and functions when accepting and conducting an Appointment."

Technical Staff Views on the suggestions

Suggestion 1- Definition of independence

We believe that the respondents are reading the definition in an incorrect manner. There are three problems with the proposed amendments as discussed below.

1. *The Code's definition is an Objective test*
2. *Proposed amendment to (a) effectively repeats what is in (b);*
3. *Additional words to (b) repeats what is prohibited by the fundamental principle of objectivity*

1. *The Code's definition is an Objective test*

For a Member in Public Practice to comply with the definition of Independence they need to comply with the whole definition of Independence. For example, a Member cannot claim to be Independent by satisfying part (a) and not part (b).

The definition of Independence in the Code when read in its entirety is an Objective test due to the incorporation of the reasonable person test.

Further, the respondents have referred to a presentation by Justice Austin where he has stated as follows:

One frequently hears business people (for example, candidates for board positions) claiming to be independent and impartial notwithstanding the most egregious associations and relationships. They assert that independence and impartiality are states of mind, and they regard the suggestion that their relationships might lead to preference or bias as an attack on their personal integrity. They fundamentally misunderstand the fiduciary requirement. The state of mind of the fiduciary is irrelevant. The question is whether the objective circumstances create a position of actual or potential conflict, leading to a real, sensible risk of preference or bias. If they do, the law simply presumes that the fiduciary's conduct is contaminated, and will not allow the fiduciary to demonstrate subjective integrity. The message is that the fiduciary should prevent the compromising circumstances from arising, or step aside, or obtain the free and fully informed consent of the principal to the proposed course of action.

Technical staff view is that APES 330 (and the Code's) definition of Independence is an objective test and thus will comply with the sentiments expressed by Justice Austin in his presentation.

The respondents have also submitted to the APESB the recent judgement in the following case from the Supreme Court of Western Australia *Re MONARCH GOLD MINING CO LTD; Ex parte HUGHES*. In the judgement in this case the judge discusses the Independence of the administrator which would equally apply to a liquidator. The relevant paragraphs dealing with independence are noted below.

[15] In *Bovis Lend Lease Pty Ltd v Wily* (2003) 45 ACSR 612, Austin J set out three separate duties of independence, impartiality and avoidance of conflict which apply to administrators. (His Honour was actually dealing in that case with the duties of a liquidator rather than an administrator. However, he makes it plain that the same principles will apply equally to administrators -- see [133]). Summarised, these duties are:

- (a) administrators must be, and be perceived to be, independent of the company, its directors and shareholders, and individual creditors;

- (b) administrators must act, and be perceived to act, impartially in discharge of the duties and responsibilities of their office; and
- (c) administrators must ensure they do not place themselves in a position where there is, or might be, a conflict between their duty to creditors and their personal interest.

[16] There are cases in which it has been said that a liquidator (and by implication an administrator) must have had no prior involvement with the company. *Re Chevron Furnishers Pty Ltd (in liq) (No 2)* [1995] 1 Qd R 125 is an example of such a case. In my view, that blanket ban goes too far. A prior association by itself will not transgress the rule requiring independence and impartiality. That was the conclusion reached by Austin J in the *Bovis* decision [134]. However, substantial involvement with a company prior to administration will, generally speaking, disqualify a person from appointment as administrator: see *Re Central Springs Works Australia Pty Ltd*; ; *Tubemakers of Australia Ltd v McLellan* (2000) 34 ACSR 169. It is all a matter of degree.

[17] This was a point taken up by Santow J in *Advance Housing Pty Ltd (in liq) v Newcastle Classic Developments Pty Ltd* (1994) 14 ACSR 230. His Honour said:

... the correct balance is struck by permitting a liquidator to act as such even if there be a prior involvement with the company in liquidation, provided that involvement is not likely to impede or inhibit the liquidator from acting impartially in the interests of all creditors or be such as would give rise to a reasonable apprehension on the part of a creditor that the liquidator might be so impeded or inhibited. In short the question should be whether there would be a reasonable apprehension by any creditor of lack of impartiality on the liquidator's part in the circumstances, by reason of prior association with the company or those associated with it, including creditors, or indeed any other circumstance.

In reality, creditors are frequently well served by an appointment of a liquidator who has some familiarity with the affairs of the company provided that the reasons that led to that familiarity do not give rise to such an apprehension or reflect an actual or perceived conflict ... (234).

[18] The test then of independence is a conflict based test -- negated if the evidence establishes 'a real and not merely a theoretical possibility of conflict': see *National Australia Bank Ltd v Wily* [2002] NSWSC 573 [22].

[19] The court is not required to assess whether the administrators will act independently, but only to assess whether there is a reasonable apprehension based on existing or past events that the administrators will not act independently. The authorities show that a mere theoretical possibility of conflict is not sufficient. Independence must be assessed by reference to such things as whether the appointee administrators have, prior to their appointment:

- (a) performed professional services of a sufficiently material nature on behalf of a principal creditor of the company to suggest that there is a reasonable apprehension they will not act independently;
- (b) provided professional services of such a degree of magnitude to the company over a long period and of such a nature as to put in doubt their capacity to independently discharge their office;
- (c) acted as auditor of the company;
- (d) acted with clear evidence of bias in the conduct prior to the application being made;
- (e) a close personal relationship with interested parties;
- (f) a close relationship with a creditor such that there was a clear tendency to prefer the interests of that creditor.

[20] These principles emerge from a number of cases including *Domino Hire Pty Ltd v Pioneer Park Pty Ltd (in liq)* (2003) 21 ACLC 1330; *Re Ross Wood & Sons Pty Ltd (in liq)* (1997) 23 ACSR 291; *Re Biposo Pty Ltd* (1995) 13 ACLC 1271 and *BL & GY International Co Ltd v Hypec Electronics Pty Ltd (in liq)* [2004] NSWSC 1119.

Technical staff view is that objective test of independence in APES 330 and the detailed requirements of Section 4 of APES 330 which deals with professional independence of a Member in Public Practice aligns with the legal precedence noted above.

2. Proposed amendment to (a) effectively repeats what is in (b)

The amendment proposed in part (a) of the definition effectively repeats what is now in part (b) of the definition.

According to the existing definition of Independence, part (b), implies that a member has to avoid facts and circumstances that compromise the member's integrity, objectivity and professional integrity. It also says that a reasonable and informed third party must reach the same conclusion (must be seen to be independent). It is important to remember that to be independent a member must have both (a) and (b). Therefore the proposed suggestion to part (a) of the definition effectively repeats what is in part (b) of the existing definition.

3. Proposed additional words to (b) repeats what is prohibited by the fundamental principle of objectivity

Part (b) of the existing definition of Independence imposes an obligation on the Member to comply with the fundamental principle of objectivity. The fundamental principle of objectivity of the Code states as follows:

120.1 The principle of objectivity imposes an obligation on all Members not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others.

120.2 A Member may be exposed to situations that may impair objectivity. It is impracticable to define and prescribe all such situations. Relationships that bias or unduly influence the professional judgment of the Member should be avoided.

Accordingly, the technical staff view is that what is proposed is already covered in the existing definition of independence which requires a Member to comply with the fundamental principle of objectivity.

In conclusion, the Technical Staff view is that no changes are required to the existing definition of Independence in APES 330 (and the Code). It should be noted that the revised International Code has gone through a worldwide exposure process in the last 2 years and that one of the definitions that has not changed is the definition of Independence.

Suggestion 2 Inclusion of an overarching principle

Technical staff agrees with the respondents that there is a benefit in the inclusion of an overarching independence requirement. We have made the following amendments to the respondents' suggestion to achieve consistency with the APESB drafting conventions, and the fact that under paragraph 4.2 a Member may fall within an exception or obtain court approval to accept or continue an Appointment.

"Subject to paragraph 4.2, A Member in Public Practice who provides Insolvency Services shall be must be, and be seen to be, Independent at all times in the performance of their duties and functions when accepting and conducting an Appointment."