

TECHNICAL STAFF BRIEFING PAPER

Item Number:	4 (a)
Date of Meeting:	17 February 2016
Subject:	<i>APES 350 Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document (APES 350) low doc offerings</i>

Purpose

The purpose of the Technical Staff Briefing Paper is to consider:

- the key issues associated with low doc offerings in the due diligence environment, and
- an assessment on the advantages and disadvantages of developing guidance on the application of APES 350 in connection with low doc offerings.

Introduction

APESB issued an exposure draft of APES 350 (APES 350 ED) on 29 April 2015 for a 45-day comment period. During the exposure draft consultation period, APESB received a submission that requested further guidance in respect of the application of APES 350 in connection with low doc offerings and the circumstances in which it is appropriate to provide an APES 350 Due Diligence Sign-Off.

This matter was discussed at the APES 350 taskforce meeting held on 16 July 2015. The majority of the taskforce was of the view that the decision to provide an APES 350 Due Diligence Sign-Off in a low doc offering scenario should be considered based on the specific circumstances of each engagement, and would require lengthy discussions with the various parties involved in the due diligence process to arrive at a resolution as there is no formal process or framework to refer to in a similar manner for a Public Document.

At the August 2015 APESB Board Meeting, the Board was provided with an update on the issue of the application of APES 350 in connection with low doc offerings. The Board noted the matter and requested that Technical Staff develop a briefing paper that explores the key issues associated with low doc offerings in the Due Diligence Committees (DDC) environment, and to consider the benefits of developing additional guidance on this matter.

Consequently Technical Staff consulted with the taskforce members (who are subject matter experts in this area of professional practice) for their feedback in relation to the key issues faced by Members in Public Practice in the low doc environment.

This briefing paper explores the key issues and performs an assessment on the advantages and disadvantages of developing additional guidance.

Background

Application of APES 350

APES 350 was developed to apply primarily to Members in Public Practice who provide services in respect of the issue of Public Documents¹. When a company issues a Public Document in respect of an issue of shares or an interest in a relevant entity, the board of directors are entitled to a Due Diligence defence in accordance with the *Corporations Act 2001* if they have undertaken due diligence procedures to ensure disclosure to investors is not false or misleading including by omission. As market practice has evolved, these procedures typically include the establishment of a DDC to perform certain due diligence activities and advise on the content of the proposed Public Document.

Paragraph 1.10 of APES 350 provides flexibility to Members in Public Practice to use their professional judgement and to apply APES 350 to the extent practicable in other circumstances such as low doc offerings.

Nature of low doc offerings

Low doc offerings are securities offerings undertaken by entities whose securities are already listed, and are characterised by the preparation and issue of a document other than a Public Document. Generally, the document contains limited financial and other information and takes the form of a presentation-style document. The capital raising may be a stand alone transaction or the capital may be being raised immediately prior to an acquisition or refinancing. It should be noted that low doc offerings are not governed by the same requirements and disclosure obligations as Public Documents.

Sections 708, 708AA and 1012AA of the *Corporations Act 2001* permit an entity to make an offer of quoted securities and quoted interests without a Disclosure Document or Public Disclosure Statement² (PDS) where the offer is a rights issue³ or placement⁴.

In 2007 ASIC permitted ASX-listed companies to undertake 'low-doc' rights issues by way of releasing to the market a 'cleansing notice'⁵ at the time of announcing the rights issue or placement, instead of issuing a prospectus⁶.

Low doc equity raisings are generally undertaken by a listed company in a time frame that typically does not permit the performance of due diligence procedures to the same extent as the process associated with the issue of Public Documents. The work undertaken by a Member in Public Practice can vary significantly from one low doc engagement to another and it is only in some of these engagements that procedures may be performed at the same

¹ Public Documents is defined in APES 350 as a Disclosure Document, Product Disclosure Statement or other documentation provided to shareholders, unit holders or holders of a relevant interest in an entity (or which is provided to management of an entity) in relation to a scheme of arrangement under Part 5.1 of the *Corporations Act 2001* or a takeover or compulsory acquisition under Chapter 6 of the *Corporations Act 2001*.

² A disclosure document for use in offers of financial products to retail investors and must contain such information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire a product (section 1013E of the *Corporations Act 2001*).

³ A rights issue (or entitlement offer) in which all existing shareholders are offered the right to subscribe for additional shares in the company on a pro-rata basis having regard to their existing shareholding.

⁴ A type of equity raising structure available to an ASX-listed company under which sophisticated or professional investors, that may include a single cornerstone investor or a group of new or existing institutional investors, subscribe for additional shares representing up to 15% of the company's existing capital.

⁵ A Cleansing Notice confirms that the market has all information the entity would be obliged to release under the continuous disclosure requirements, including information on incomplete proposals or negotiations. It should be issued at the time of the share offer.

⁶ In terms of content, a prospectus is similar to a PDS, although a PDS does have a different and more prescriptive content requirement. The main difference is that for a PDS, the benchmark is set by reference to a retail client whereas for a prospectus, the needs of the investors and their professional advisers are considered.

level as that for a Public Document; and thus enable a Member to sign an APES 350 Due Diligence Sign-Off.

The cleansing notice that must be issued in connection with a 'low doc' issue must disclose to the market all information that the company has withheld from the market on the basis of an exception to its continuous disclosure obligations, and which (in broad terms) is material to the decision as to whether to subscribe for shares under the issue.

If this cleansing statement is defective, either because it contains a misleading or deceptive statement or omits relevant information, those involved with the offer (including the directors) may be liable for any loss suffered by investors. There is no 'Due Diligence' defence for a defective cleansing statement. Similarly, there is no 'Due Diligence' defence for any defective disclosure that is made by a company in connection with a placement.

Consideration of issues

APESB has been advised that some Members in Public Practice and other advisors involved in capital raisings are experiencing difficulties in agreeing on the level of work and type of engagement to be performed in a low doc environment that would justify the issuance of an APES 350 Due Diligence Sign-Off.

Given that Australia has seen an increase in capital raisings using 'low doc' style documents, an evaluation needs to be performed to determine whether further guidance for Members in Public Practice who are involved in these kinds of engagements would be beneficial. The issues faced by Members in a low doc environment include:

(i) Nature and extent of disclosures of Financial Information

The nature and extent of disclosures of Financial Information in market announcements related to low doc offerings varies widely from case to case. As the Financial Information required is not specifically prescribed, there are instances where Members in Public Practice are being requested to provide Due Diligence Sign-Offs in low doc situations where the financial information to be disclosed is very limited, reflecting the fact that the entity is a continuously disclosing entity.

Examples of where requests for a Due Diligence Sign-Off have been made are in relation to the disclosure of a pie chart, a standalone distribution number or net asset number. However, this information has no context or reference to an appropriate framework such as the Australian Accounting Standards and thus, there is no acceptable basis for Members in Public Practice to determine whether the disclosure is misleading or deceptive.

(ii) Expectation gap on Member in Public Practice's role and deliverables

Some confusion still exists with the expected roles and deliverables on capital raising transactions. Members in Public Practice are often requested to provide Due Diligence Sign-Offs in circumstances where Members have not been engaged to undertake sufficient assurance procedures to support a review statement in relation to the financial information underlying the limited Financial Information disclosed (as no or limited Financial Information is required in a low doc offer document and there is no requirement that Financial Information which is disclosed have been audited or reviewed).

It is noted that, even if no audit or review has been performed, some advisors involved in low doc offerings still request for a Due Diligence Sign-Off to be provided, on the basis that the Member in Public Practice has performed some limited work, such as limited due diligence procedures or an agreed upon procedures engagement. This is generally not appropriate as the statements in a Due Diligence Sign-Off require an appropriate level of

assurance work to be undertaken on the Financial Information and sufficient, appropriate evidence to be obtained in order to support those statements.

(iii) Separate Engagement Teams (either from the same Firm or a different Firm) involved in different due diligence stages

If a capital raising is for the specific purpose of a transaction, such as an acquisition, that transaction may involve an acquisition due diligence stage undertaken by an entirely separate Engagement Team to those who are expected to provide for a Due Diligence Sign-Off in connection with the capital raising process. The acquisition due diligence Engagement Team may either be from the same Firm or from a different Firm. The issue faced by Members in Public Practice is that although the low doc offerings are often undertaken on the basis of very limited due diligence processes, for Members to provide a Due Diligence Sign-Off in connection with these low doc offerings they would still need to be fully involved in the due diligence process; and they would need to perform sufficient assurance procedures to support the statements in a Due Diligence Sign-Off irrespective of the level of work performed by a different Engagement Team (of the same Firm or different Firm) in a related transaction.

Another example is where Engagement Teams from the same Firm are involved in cross border transactions such as an Australian entity raising capital for an overseas acquisition. Members in Public Practice have been requested to provide Due Diligence Sign-Offs in connection with low doc offerings on the basis that extensive due diligence procedures have been performed by an overseas network Firm (i.e. different legal entity/jurisdiction) on a target entity (acquiree), and that the Australian Firm should be able to perform some agreed-upon procedures and issue a Due Diligence Sign-Off.

In both of these scenarios as the capital raising associated with low doc offerings typically involves more limited processes, a shorter timeframe, and as there is no prescribed framework (in comparison to a Public Document), the most likely scenario is that the Member in Public Practice will be unable to perform sufficient assurance procedures to enable them to provide a Due Diligence Sign-Off.

(iv) DDC Observer role

The Member in Public Practice's role is generally limited to that of a DDC Observer, with only the relevant issuing company having DDC membership representation. Thus the Member has less ability to influence the roles and work undertaken in connection with information disclosed, or not disclosed, in connection with the transaction, and has less access to information, as the Member is not a party to the Due Diligence Planning Memorandum and may not be invited to attend all meetings of the DDC. The nature and scope of the role the Member undertakes as a DDC Observer impacts the sign-off the Member is able to provide.

(v) Diverse range of transactions and circumstances

The scale of low doc offerings can vary considerably from small capital raisings to capital raisings in excess of \$1 billion. The complexity of the transactions to be funded by low doc offerings also varies widely from simple debt retirement through to transformative acquisitions of new businesses and/or into new geographies.

This leads to a wide variety of risk profiles for the issuers and their underwriters which consequently can lead to a broad range of requests of Members in Public Practice (i.e. from no Due Diligence Committee role at all, to simple agreed upon procedures engagements, to requests for assurance opinions over Financial Information in market announcements and APES 350 Due Diligence Sign-Offs).

This vast diversity and the unregulated nature of low doc offerings challenge the development of guidance that may enable Members to apply the same approach in every scenario or that could satisfactorily address all possible circumstances.

(vi) Time frame requirements

The time frames in which low doc offerings take place can vary widely from several days to many months, and consequently the due diligence process implemented by the issuer can vary greatly but is often significantly truncated and limited in scope.

The issue for Members in Public Practice, particularly in shorter time frames, is that Members may not have sufficient time to perform a review of the Financial Information under the relevant assurance standards (i.e. performance of assurance procedures to the same extent as the process associated with the issue of Public Documents) to be in a position where they are able to provide an APES 350 Due Diligence Sign-Off.

It is challenging to set a time guide to perform a review as this would depend on the scale of the offering, complexity of the transaction and the nature of the offeror.

(vii) Availability of recently audited results

The timing of the low doc offering is also a potential issue for Members in Public Practice. For example, a low doc offering which follows immediately on from audited results is a different proposition to a low doc offering in the middle or towards the end of a reporting cycle.

(viii) Level of management involvement

The level of involvement of senior management and other professional advisers, and the rigour of the due diligence processes and documentation varies widely between different low doc offerings. Therefore it is difficult to provide general guidance to determine when it might be appropriate to provide an APES 350 Due Diligence Sign-Off, including the statement about whether the due diligence enquiries undertaken in relation to the Financial Information are reasonable.

Rationale for the development of guidance in respect to low doc offerings

APES 350 requires Members in Public Practice to use their professional judgement when determining whether to provide a Due Diligence Sign-Off in a low doc environment. Paragraph 1.10 of APES 350 provides that the Standard should be applied to the extent practicable where a Member is reporting to a Due Diligence Committee in respect of Engagements which are not in connection with Public Documents.

However, APES 350 does not specifically refer to low doc engagements. The provision of specific references to low doc situations within the Standard is likely to confuse Members in Public Practice as APES 350 is meant for Public Documents.

The specific issues in relation to which some Members in Public Practice are seeking clarity when providing Due Diligence Sign-Off on low doc offerings are:

- Circumstances in which an APES 350 Due Diligence Sign-Off can be provided by a Member in Public Practice. For example, it may be possible to provide an APES 350 Due Diligence Sign-off if the Financial Information has been subjected to sufficient assurance procedures in accordance with Auditing and Assurance Standards. A Due Diligence Sign-Off should not be provided in situations where limited procedures have been performed such as limited due diligence procedures or agreed-upon procedures;

- A Due Diligence Sign-Off should not be provided where there is limited Financial Information being disclosed or if the Financial Information has not been prepared in accordance with an appropriate framework such as Australian Accounting Standards.

Some stakeholders have noted that any guidance in respect to low doc offerings should be principles based (i.e. matters for the Members in Public Practice to consider) and should not aim to provide a complete list of considerations for making professional judgements when providing a Due Diligence Sign-Off on low doc offerings.

The potential benefits of developing guidance for Members in Public Practice include:

- A practice aid to assist Members (particularly small and medium sized Firms that may have less experience in low doc offerings) in applying the principles in APES 350;
- Basis for Members to perform preliminary assessments and matters to consider when providing a Due Diligence Sign-Off in connection with low doc offerings;
- Promote some form of comparability and uniformity in practice; and
- May assist Members in exercising professional judgement when providing a Due Diligence Sign-Off in connection with low doc offerings.

Arguments against developing guidance in respect to low doc offerings

The current APES 350 provides flexibility that allows the Member in Public Practice to assess the Engagement on a case by case basis and exercise professional judgement as to whether a Due Diligence Sign-Off can be provided.

In addition, Members in Public Practice should apply the existing guidance in paragraphs 7.1 and 7.2 of APES 350 to form an appropriate view on whether they should provide a Due Diligence Sign-Off. Paragraph 7.3 of APES 350 also mandates that once a Member in Public Practice has determined that a Due Diligence Sign-Off can be provided, the Due Diligence Sign-Off must be provided in whole.

Accordingly the challenges to provide guidance to Members in Public Practice in respect of low doc offerings are:

- Difficulty to meet the common information needs of a broad range of primary users who have dissimilar information needs and expectations;
- Difficulty to specify uniform guidance for Members in Public Practice due to the wide variety of low doc engagements;
- Difficulty to provide meaningful guidance other than general principles-based guidance that may cover the diverse scope and scale of low doc offerings (which may be ambiguous in practice);
- Due to the existence of guidance, Members in Public Practice may attempt to apply the guidance in circumstances where it is unsuitable; and
- Guidance on application of APES 350 is unnecessary as the current requirements and guidance in APES 350 is sufficient.