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Basis for Conclusions: APES 305 Terms of Engagement

Prepared by the Technical Staff of the Accounting Professional & Ethical Standards Board

BASIS FOR CONCLUSIONS:

APES 305 Terms of Engagement

This basis for conclusions has been prepared by technical staff of Accounting Professional & Ethical Standards Board (“APESB”). This document has been reviewed and approved by the Board of the APESB and is provided for the benefit of stakeholders to gain an understanding of the background to the development of APES 305. However, the basis for conclusions **does not** form part of APES 305 Terms of Engagement and is not a substitute for reading the standard.

Background

Accounting Professional & Ethical Standards Board Limited (APESB) proposes to issue the Standard APES 305: Terms of Engagement setting out mandatory requirements and guidance for those members in public practice who provide professional services to clients.

The predecessor standard APS 2: Terms of Engagement was issued in August 2000. Since that time there have been significant changes that have affected the accounting profession. Thus the key changes in APES 305: Terms of Engagement are:

- Mandating the documentation and communication of terms of engagement;
- As all states have now enacted professional services legislation, references to the New South Wales legislation were removed. The proposed standard now includes mandatory requirements with which members in public practice need to comply when participating in a limitation of liability scheme under the relevant state legislation; and
- Examples of engagement letters were removed. APESB believes it is more appropriate for the accounting professional bodies to provide guidance and examples to their members based on the principles stated in this Standard and applicable legislation.

The proposed APES 305 includes mandatory requirements and guidance in respect of:

- Terms of engagement for professional services;
- General contents of an engagement document;
- Recurring engagements; and
- Limitation of liability.

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APESB issued an exposure draft of the proposed standard with a comment deadline of September 14, 2007. APESB received submissions from the professional bodies, two big four audit firms, the Australasian Council of Auditors General and individual members. As a result of the comments received, APESB implemented a number of changes in finalising the text of APES 305 Terms of Engagement. The following summarises the more significant issues raised by respondents, and how APESB addressed them.

Scope and Application (Paragraph 1.1¹)

The standard was intended to apply from the operative date of 01 January 2008. However, as APES 220 Taxation Services included a similar provision to document and communicate the Terms of Engagement, the effective start date was delayed to 01 July 2008 in line with APES 220 Taxation Services. Concerns were raised by respondents that potential confusion would arise in relation to application of the standard to engagements that may be ongoing as of the effective date of the new standard. APESB considered the respondents' comment and amended the standard to state that the standard is only effective for engagements commencing on or after the effective date of 01 July 2008.

Definition of Engagement Document (Section 2)

Use of the term "engagement document" recognises the importance of documenting and communicating the terms of engagement to the client whatever the form such documentation takes. "Engagement document" replaced the term "engagement letter". ED 04/07 used the term "engagement letter" which some respondents suggested was not required as the important issue was for the terms to be documented and communicated to the client and that it was not necessary for it to be in the form of a letter and that other means of achieving the same objective are acceptable.

Obligations Imposed by Law (Paragraph 3.6)

The intent of this paragraph is to state that where engagement terms are imposed by law, the member need not reproduce all of those terms in the engagement document, but can incorporate them merely by making reference to the terms.

Some respondents noted that where the scope and objectives of the engagement are governed by law, APES 305 could be interpreted to indicate that the documentation and communication of such terms may be optional. Others stated that it would be preferable to have such terms incorporated into the engagement terms documented and communicated by reference to the relevant law.

¹ Paragraph numbering reflects the numbering in APES 305 and may not reflect ED 04/07.

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APESB agreed with both of these observations, which are reflected in a revision of paragraph 3.6, which now state that reference should be made to the applicable provisions of the law in the engagement document.

Contents of Engagement Document – Scope (Paragraph 4.4c)

Consistent with the discussion of paragraph 3.6 above, where engagement terms are imposed by law, such terms may be incorporated by making reference to them. Thus, legislation and professional standards that may be relevant need to be referred to in the engagement document. Some respondents raised concerns that paragraph 4.4c in ED 04/07 could be interpreted to indicate that the member was providing legal advice. APESB agreed with the respondents' concerns and amended the phrase to read "references to any legislation" as opposed to "application of any legislation".

Contents of Engagement Document – Engagement Output (Paragraph 4.5c)

The aim of section 4 of the Standard is to detail items that should be considered for inclusion in the engagement document. One such item is the nature of any important or unusual disclaimers that limit the member's liability. Concerns were raised that by including the requirement to state the effect of disclaimers and arrangements, the member may be required to provide legal advice on the "effect" of disclaimers. Therefore the paragraph was rephrased to exclude "the effect" of disclaimers or arrangements, requiring only that member disclose "the nature" of any disclaimer or arrangement.

Contents of Engagement Document – Involvement of Other Members (Paragraph 4.7)

One of the respondents noted that in certain instances a member in public practice may utilise the services of another member to provide a professional service. Where other Members in Public Practice may assist or be involved in an engagement, it is important that the client is aware of such intent at the outset of the engagement. Hence, their potential involvement needs to be disclosed in the engagement document. A new paragraph was inserted in section 4 to provide guidance in this regard.

Contents of Engagement Document – Ownership of Documents (Paragraph 4.9)

In ED 04/07 this paragraph attempted to address the situation where disputes arose due to practitioners withholding working papers or client information because of unpaid fees. By clearly stating any ownership restrictions of documents at the beginning of an engagement, disputes relating to ownership of documents may be avoided.

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Whilst respondents agreed with the need to include this paragraph, some raised concerns over the wording relating to retention of a lien. APESB clarified this issue by stating that where there is “a policy of seeking to exercise right of lien...” that this policy should be disclosed in the engagement document.

Limitation of Liability under Professional Services Legislation (Paragraph 6.2)

The engagement document needs to communicate to the client the limitation of liability provisions under the relevant Professional Services Legislation. Some respondents raised an issue that the wording in ED 04/07 could be interpreted to mean that the client may have to seek legal advice in respect of the operation of the relevant professional services legislation scheme and its impact on the engagement. It was not the intent of this paragraph that practitioners be required to advise their clients to seek such advice or put the clients on notice, but rather that practitioners make clients aware that they operate under a scheme and that their liability may be limited. One respondent asked whether such advice means that a member could potentially be required to communicate all provisions of relevant legislation, which would place a significant obligation on the member.

APESB considered the issues raised and redrafted the paragraph to state that members in public practice have only a professional obligation to make clients aware that members are operating under a relevant professional services legislation scheme and that their liability under the scheme may be limited.