

TECHNICAL ANALYSIS PAPER

Subject: ED 01/12 APES GN 30 Outsourced Services – Summary and Analysis of Key Issues Raised by Respondents

Purpose

The purpose of this paper is to provide the APES GN 30 Taskforce and the APES Board with:

- a summary of key issues raised by respondents in response to APESB's ED 01/12 APES GN 30 *Outsourced Services*; and
- Technical staff preliminary comments, views and recommendations.

A summary of the major issues raised by respondents and Technical staff preliminary comments, views and recommendations on the issues raised in the Exposure Draft is given below.

1. Review of Respondents' Comments

(i) Consistency with international developments in Outsourcing

[GC2, GC3, GC6, GC10 - GC13, GC18, GC35]

Respondents' Comments

A number of respondents noted their preference for the development of internationally consistent standards and guidance whilst noting the absence of an international equivalent. One respondent stated that proposed guidance note imposes additional layers of obligation on Members that do not apply to other service providers. Other respondents questioned the need for guidance in Australia when Outsourcing is not unique to the local environment. It was also suggested that the guidance note as currently drafted does not consider the extent to which the proposed guidance is consistent with, or more onerous than, guidance issued by other countries.

Technical Staff Response

APESB is a national standards setter and has the mandate to issue professional and ethical standards for the accounting profession in Australia. For the majority of APESB's pronouncements (over 80%) there are no international equivalents. One of the reasons for this is that IESBA's work primarily focuses on the Code of Ethics and to date IESBA has issued no other pronouncement. However, the situation is quite different when considering International Accounting or Auditing Standards where the equivalent international Boards have issued a suite of standards for their respective areas that are adopted internationally.

In the short term it is unlikely that IESBA will be issuing professional and ethical standards other than the Code. Accordingly, when there are matters that need to be specifically addressed in a national jurisdiction then the National Standards Setter can consider this and issue national standards as appropriate. For example, APESB has issued standards for Valuation Services, Forensic Accounting Services and Insolvency Services for which there are no international equivalents.

(ii) Structure and drafting style of the proposed guidance note

GC19, GC24 – GC 29, SC49, SC53, SC55, SC56,

Respondents' Comments

All respondents raised concerns with the current structure and drafting style of the proposed guidance note. A respondent suggested that the degree of detail and prescriptive tone of the document results in the proposed guidance note reading more like a standard than like guidance. Some of the other respondents raised similar concerns.

Technical Staff Response

The objective of APES GN 30 is to provide Members with guidance when utilising or providing Outsourced Services. It was never intended that APES GN 30 would be read in a manner to imply that it contains mandatory requirements but rather serve as identifying best practice suggestions for Members. The proposed guidance note should incorporate sufficient flexibility such that guidance could be interpreted as intended and applied across a range of Outsourced Service arrangements.

Technical staff will perform a review of the drafting style to incorporate sufficient flexibility and amend where necessary to reflect the original intention of the guidance note.

(iii) Interaction of APES GN30 with ASA600 and application to group audits

GC8, SC8, SC32

Respondents' Comments

Some of the respondents highlighted the requirements and application material for the conduct of group audits contained in ASA 600 *Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors)* as well as using other experts in audit engagements which is addressed by ASA 620 *Using the Work of an Auditor's Expert*. These are based on the international equivalent standards ISA 600 and ISA 620 and establish the auditor's obligations in a group audit situation and in respect of the use of other experts for the purpose of audit engagements. The majority of the respondents suggested that the guidance note should specifically exclude these situations as they are addressed by auditing standards.

Technical Staff Response

When drafting APES GN 30, the guidance note was not intended to capture group audits and the use of other experts in audit engagements. In these circumstances the Client is aware of what is occurring and appropriate disclosures would be already be made to the Client.

Accordingly the preliminary technical staff view is that there is merit in excluding these circumstances from the scope of the proposed guidance note and for the taskforce to

consider this matter further. Thereafter the taskforce recommendation can be communicated to the Board.

(iv) Interaction with other standards and regulations

GC23, SC8

Respondent's Comments

A respondent noted the operation of other guidance and standards for Outsourced Services. Examples highlighted include CPS 231 issued by the Australian Prudential Regulatory Authority (APRA), which contains requirements and guidance for entities regulated by APRA.

Technical Staff Comments

During the development phase of the proposed APES GN 30 the APRA standards were considered by the taskforce. Some of the definitions and guidance developed are based on these standards. APRA standards will generally be applicable to Members in Business and paragraph 1.9 allows sufficient flexibility in this regard.

(v) Treatment of existing contracts

GC21, SC7, SC71

Respondent's Comments

Some respondents noted the need for the guidance note to address existing Outsourced Service arrangements and the method by which such arrangements should be transitioned to best practice arrangements. It was noted that many Members in Public Practice participate in outsourcing arrangements and have contracts already in place. Legally binding obligations will arise from any such existing contracts and as such the respondent suggested that the Guidance Note needs to provide clear principles based guidance concerning transition from existing contractual obligations.

Technical Staff Response

We note that GN 30 is not a standard and therefore generally it would not be appropriate to include formal transitional provisions. However, to address the issue raised by respondents' amendments are required to clarify the prospective application of the proposed GN 30 particularly where existing contracts are in place.

Technical staff recommends that the taskforce consider having an actual commencement date for the application of APES GN 30 to prospective arrangements and present this for further consideration by the Board.

(vi) Scope of guidance in relation to the provision of Outsourced Services

SC1- SC4, SC6

Respondent's Comments

Many of the respondents disagree with the application of the guidance to the provision of Outsourced Services suggesting that only Utilisation of such services should be within the scope of the guidance. The general opinion of respondents can be summarised by one comment received which states that Outsourcing should not be viewed as a stand-alone service offering rather a method by which an underlying Professional Service is delivered. Such services are addressed by existing standards and guidance and therefore should not fall within the scope of APES GN 30.

Some respondents have also raised the issue of cross border teams in the larger firms and the application of the proposed Guidance Note to Network Firms who have common quality control procedures.

Technical Staff Response

Whilst we acknowledge that there are a number of standards that address services which may be offered by a Member in Public Practice, there is benefit in giving guidance to Members when providing Professional Services as part of an Outsourcing arrangement.

Existing standards assume that the Member in Public Practice is primarily providing the services, not a Third Party Service Provider. Outsourcing a Professional Service carries its own inherent risks which are directly addressed by this guidance note. For example, a Member may be providing an Outsourced Service to a non-member that may not have considered threats to the principles of the Code such as threats to confidentiality. On this basis, Technical Staff are of the view that the provision of Outsourced Services should remain within the scope of APES GN 30.

The issue of cross border teams and Network Firms to be discussed further with the taskforce and thereafter Board direction will be sought.

(vii) Definitions

SC13- SC31

Respondent's Comments

All respondents raised concern with the definitions of key terms such as "Outsourcing", "Material Business Activity", "Outsourced Service Provider", "Outsourcing Agreement" and "Outsourced Service". Some respondents noted that there was a lack of clarity with regard to key definitions and one respondent stated that the ED does not adequately define the term "Outsourcing" due to the circular nature of key definitions.

A respondent commented that the ED does not adequately define the term "Outsourcing" with the argument as follows:

The ED defines Outsourcing to mean the transfer of responsibility for conducting processes to an Outsourced Service Provider. An Outsourced Service Provider is defined to mean an entity that is providing services in accordance with an Outsourcing Agreement. An Outsourcing Agreement is defined to mean the document in which the terms and conditions of an Outsourced Service are set out. An Outsourced Service is

defined to mean a service involved in Outsourcing a Material Business Activity to an Outsourced Service Provider

Technical Staff Response

Technical staff considered the definitions included in the guidance note and agree that the terms are circular leaving the reader without a succinct definition of the subject matter of the guidance note, Outsourcing. Technical staff recommends that the key defined terms, as listed above, be reviewed by the taskforce to enhance clarity and present for subsequent consideration by the Board.

Technical staff believes that while there are other comments that were raised relating to these defined terms, if the matter of circularity of the definitions is resolved, then it would assist in resolving some of the other issues as well.

(viii) Disclosure requirement for written consent

SC40, SC41, SC43, SC44, SC46

Respondents' Comments

Some respondents do not see the benefit of disclosing Outsourcing arrangements to Clients and do not understand the necessity to obtain written consent for such arrangements. It was stated that standard engagement terms which state that part of the services for a client may be Outsourced or provided outside of Australia is sufficient disclosure to clients. Most of the respondents did not think it necessary to disclose the nature and extent of the Professional Service being Outsourced.

Another respondent noted that since the Member in Public Practice retains the primary responsibility to deliver the Professional Service, the extent to which Outsourced Services are used is no more relevant for disclosure to a Client than any other valid business practices employed by the Member in Public Practice. Furthermore it would be unwieldy and burdensome for large firms to obtain consent from each Client.

These arguments are not unique to Australia. The Journal of Business Ethics recently published the article: *Deficiencies in the Code of Conduct: The AICPA Rhetoric Surrounding the Tax Return Preparation Outsourcing Disclosure Rules* ("the article"). The authors of this article consulted a number of resources in their investigation of the AICPA disclosure requirements for outsourced tax returns, and noted that resistance to disclosure of offshoring of tax return preparation to clients. They concluded that required disclosures from the AICPA are inadequate and act to conceal offshoring of tax return preparation.

The article found that, similar to local respondents to ED 01/12, the US has seen much resistance to disclosure of offshoring arrangements. Accordingly, as a result of this pressure the language adopted by AICPA Ethics Ruling No. 112 under Rule 102 provides the member with significant flexibility in relation to disclosing offshoring disclosures as it states:

Before disclosing confidential client information to a third-party service provider, a member should inform the client, preferably in writing, that the member may use a third-party service provider. AICPA 2004a)

The article suggests that the two main features that the disclosure should be comprised of are opaque. That is, the member's intent to outsource and the identity and location of the

Third Party Service Provider. Further, there is no requirement for specific disclosure of off shoring.

The article subsequently noted members of small firms that do not outsource tax returns and non-practising members were critical of the AICPA approach to this disclosure. In contrast, the large firms were supportive of this style of disclosure and were opposed to providing specific disclosures to Clients.

Technical Staff Response

Technical staff considered the issues raised in light of the fundamental principles of the Code, in particular, confidentiality. Clients are entitled to know whether their confidential information is being transferred to another entity, whether local or overseas, and should be given the opportunity to consider the manner in which their information will be managed.

This is particularly relevant to offshored Outsourced Service Providers that may not be subject to the same legal and confidentiality requirements as they are no longer under the same jurisdiction as the Client or the Member in Public Practice. This opinion is supported by the AICPA's *Ethics Ruling on Independence, Integrity and Objectivity* which contains the following discussion:

112. Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services

.224 *Question* – A member in public practice uses an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined by accounting principles generally accepted in the United States) or an individual not employed by the member (a third-party service provider) to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients. Does rule 102, *Integrity and Objectivity* [ET section 102.01], require the member to disclose the use of third-party service provider to the client?

.225 *Answer* – Yes. The concept of integrity set forth in Rule 102 *Integrity and Objectivity* [ET section 102.01] and Article III, *Integrity* [ET section 54] requires a member to be honest and candid. Clients might not have an expectation that a member would use a third-party service provider to assist the member in providing the professional services. Accordingly, before disclosing confidential client information to a third-party service provider, a member should inform the client, preferably in writing, that the member may use a third-party service provider. This disclosure does not relieve the member of his or her obligations under ethics ruling No. 1 [ET section 391.001-.002] under Rule 301, *Confidential Client Information* [ET section 301.01]. If the client objects to the member's use of a third-party service provider, the member should provide the professional services without using the third-party service provider or the member should decline the engagement.

A member is not required to inform the client when he or she uses a third-party service provider to provide administrative support-services (for example, record storage, software application hosting, or authorised e-file transmittal services) to the member.

Given the above discussion and the potential threat against the fundamental principle of confidentiality, the suggested disclosure of Outsourced Service arrangements to the Client is considered best practice that should be adopted by a Member in Public Practice.

2. Technical Staff Recommendations/Way forward

Technical Staff recommend that the taskforce discuss the contents of this Technical Analysis paper and agree on the proposed way forward on the key issues raised by respondents. Taskforce discussions and conclusions reached will then be presented to the Board for further consideration.

3. Summary

The majority of respondents have issues with the proposed APES GN 30 and do not support the guidance in its current form due to the reasons noted above. Further work needs to be completed by the Taskforce and Technical Staff. Board direction will be sought on the key issues and thereafter a revised version of the proposed guidance note can be prepared for the Board's consideration.

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Date: 1 July 2012