

26 April 2021

Mr Channa Wijesinghe
Chief Executive Officer
Accounting Professional & Ethical Standards Board
Level 11, 99 William Street
MELBOURNE VIC 3000

Dear Channa,

Submission on Exposure Draft 01/21 Proposed Guidance Note: APES GN 30 Outsourced Services

We welcome the opportunity to provide the Accounting Professional & Ethical Standards Board with our comments on Exposure Draft 01/21 (ED 01/21).

Nexia Australia represents the Nexia network firms in Australia comprising seven independent Chartered Accountancy firms located in Adelaide, Brisbane, Canberra, Darwin, Melbourne, Perth and Sydney.

Nexia Australia firms service clients from small to medium enterprises, large private company groups, not-for-profit entities, publicly listed entities and other public interest entities and includes market leaders in many sectors of business.

Nexia Australia is a member of Nexia International, a global accounting and consulting network ranking 8th in size with annual turnover of USD 4.5 billion and employing over 34,500 people in over 120 countries.

Comments on the proposals

For the reasons identified below, we are concerned that the proposals contained in ED 01/21, and by extension contained in APES 305 *Terms of Engagement (revised December 2020)* (APES 305), are unclear, difficult to apply in practice, and will add additional costs to firms.

Difficulty in operationalising the proposals

The Nexia Australia network comprises seven, separate, independent firms with multiple service lines providing different services to different clients. The proposals require us to consider whether the Outsourced Services definition is met at multiple levels (firm, division, and client) – potentially resulting in engagement teams adding and removing engagement letter disclosures on a client by client basis.

Because APES 305 and ED 01/21 requires the assessment of whether outsourcing is material should be made from both the perspective of the firm and the client, a further complication is that the engagement team may not know whether, and to what extent, they intend to outsource services at the time an engagement letter is issued to a client. ED 01/21 does not provide guidance on how a firm should address this situation.

The examples contained in ED 01/21 do not illustrate the 'nature and extent' of the disclosures required by APES 305 and GN 30. However, based on the requirements in paragraphs 3.6 and 3.7 of APES 305 and paragraphs 3.9 and 3.11 of ED 01/21, it appears that the Board requires specific description of those matters rather than a broad general description of those potential arrangements.

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The difficulties identified above may mean that a firm, business unit, or individual engagement team may not be able to accurately identify with sufficient specificity in an engagement letter if, and to what extent, Outsourced Services may be utilised.

We recommend that the Board reconsider these requirements and provide additional practical guidance to assist practitioners operationalise the proposals.

Identifying internal activities

- working paper software and other internal systems

APES 305 and ED 01/21 defines a Material Business Activity as excluding “the internal operational activities of the Firm or activities that merely support the Professional Services delivered to the Client, such as record storage, software application hosting or informational reference sources”.

It could be argued that most software utilised by a Firm “merely supports” the services delivered to a client. For example, a Firm’s use of cloud based software such as MyWorkpapers, MYOB AE, or CaseWare Cloud could be viewed as an alternative to paper-based working papers and ‘merely supports’ the firm’s ability to provide business services and assurance services in an efficient manner, notwithstanding client data would be held on those platforms. Although Example 5 of ED 01/21 is unclear whether the SaaS licence is held by the Member or the Client, it appears to suggest that use of third party software is a Cloud Computing arrangement.

Given that many assurance practices use either off-the-shelf or bespoke audit and accounting working paper software packages, we strongly recommend that the Board clarifies its intention whether the use of cloud-based working paper software represents a Cloud Computing arrangement.

If the Board’s answer to the above is in the affirmative then it is likely that the use of cloud-based working paper software will always represent an Outsourced Service because, by its nature, it has the potential, if disrupted, to significantly impact upon the quality, timeliness or scale of Professional Services offered by a Member in Public Practice or received by a Client. We suggest that the Board clarify this point.

We refer to the conclusion to the scenario in Example 9 that the arrangement would meet the definition of Cloud Computing. Firms employ a myriad of cloud-based platforms that can hold client data and information, such as Sharepoint, Citrix, Sharefile, email systems, and other client portals, practice management systems and document management systems.

However, Example 9 is different to example 12 involving ‘the provision of record storage, computer support and backup services’. Example 12 states that ‘where these activities are internal operational activities of the Firm, they are not considered to be Material Business Activities’, but does not conclude whether they represent Cloud Computing arrangements. We suggest that the Board clarify this point.

- Cloud-based back-ups

Firms may utilise internal server-based software to provide services to clients. Those applications would not represent Cloud Computing. However, to ensure appropriate IT and business risk management, cloud-based backups are commonly utilised.

On that basis, it is highly likely that every firm has client information held in one way or another via cloud computing. Hence, it would appear that every Australian engagement letter should include reference to the fact that clients’ information is held by third parties via Cloud Computing.

If this is the Board’s intention, we recommend that APES 305 and GN 30 clearly state that fact.

Disclosures

In the absence of illustrative disclosures within the proposed GN 30, it is unclear whether the disclosures referred to in paragraphs 3.6 and 3.7 of APES 305 and paragraphs 3.9 and 3.11 of ED 01/21 are intended to specifically identify every cloud based arrangement, including working paper backups, that may hold client information.

In our opinion, an obligation to specifically identify every cloud-based application utilised by a firm that *may* hold client information and data would not be appropriate as it unnecessarily increases a firm's IT security risks by assisting bad actors to target specific cloud based systems.

- Differential disclosures if cloud computing is deemed an outsourced service

We note that APES 305 and proposed GN 30 contains different disclosures depending upon whether Cloud Computing is an Outsourced Service or not:

Cloud Computing is an Outsourced Service	Cloud Computing is not an Outsourced Service
The nature and extent of the Outsourced Services [Cloud Computing] to be utilised	How the Client's confidential information will be stored

It is unclear to us:

- a) why disclosure of how the Client's confidential information will be stored is required where Cloud Computing *does not* an Outsourced Service, but is not specifically required where Cloud Computing *does* represent an Outsourced Service; and
- b) the nature of the difference between the disclosure required by paragraph 3.6 of APES 305 as it relates to Cloud Computing and paragraph 3.7 of APES 305.

To assist firms implement the requirements of APES 305 and GN 30, in our opinion, it would be helpful if the Board includes examples in the Guidance Note to illustrate the disclosures in paragraphs 3.6 and 3.7 of APES 305 and paragraphs 3.9 and 3.11 of the proposed GN 30.

Heightened risk, cost and effort

As a result of the above matters, we are concerned that the proposals:

- i) will add complexity and undue costs and effort to tailor individual engagement letters on a client-by-client basis;
- ii) do not address where engagement circumstances may change subsequent to issuing an engagement letter, which may require reassessments during the course of an engagement and possible remedial actions by engagement teams; and
- iii) will unnecessarily increase a firm's IT security risks

We recommend that the Board reconsider the requirements in APES 305 relating to the use of third party services and cloud computing.

Should you wish to discuss any aspects of our submission, please contact me at molde@nexiaaustralia.com.au.

Yours sincerely

Nexia Australia Pty Ltd

Martin Olde
Technical Director