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Basis for Conclusions: APES 350 Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document

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

Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document

BASIS FOR CONCLUSIONS:

APES 350 Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document

This basis for conclusions has been prepared by technical staff of Accounting Professional & Ethical Standards Board Limited (“APESB”). This document has been reviewed and approved by the Board of Directors of APESB and is provided for the benefit of stakeholders to gain an understanding of the background to the development of APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document* (APES 350).

The basis for conclusions **does not** form part of APES 350 and is not a substitute for reading the standard.

Background

APESB has issued the Standard APES 350 setting out mandatory requirements and guidance for Members in Public Practice who provide Professional Services to a Client which comprise participating in and/or reporting to a Due Diligence Committee (DDC) as a DDC Member, DDC Observer or Reporting Person.

APES 350 includes mandatory requirements and guidance in respect of:

- Fundamental responsibilities of Members in Public Practice;
- Professional Engagement and other matters;
- Roles and obligations of a Member in Public Practice in a due diligence process in connection with a Public Document;
- Documentation;
- Reporting;
- Professional fees; and
- An approved form of Due Diligence Sign-Off.

APESB issued an exposure draft of the proposed standard (APES 350 ED) in June 2009 with a comment deadline of 24 July 2009. Submissions were received from the professional accounting bodies, firms, and Australian Financial Markets Association (AFMA). In response to the comments received, APESB has made a number of changes to APES 350. The following summarises the significant issues raised by respondents, and how APESB addressed them.

Definitions

APES 350 ED had definitions of “Due Diligence Sign-Off” and “Reporting Person” but did not contain definitions of “DDC Member” or “DDC Observer”. In response to suggestions made by respondents, the terms “DDC Member” and “DDC Observer” have been defined and minor amendments made to the definitions of “Due Diligence Sign-Off” and “Reporting Person”. APES 350 recognises that a Member in Public Practice may undertake one or more roles of DDC Member, DDC Observer

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and Reporting Person when providing Professional Services to a Client which comprise participating in and/or reporting to a DDC in connection with a Public Document.

APES 350 defines these three roles and the Due Diligence Sign-Off in the following manner:

DDC Member means a Member in Public Practice who is engaged by a Client to provide Professional Services as a member of a Due Diligence Committee and who will participate in the Due Diligence Committee's decisions, sign all the collective reports and other documents issued by the Due Diligence Committee and in most instances prepare a Due Diligence Sign-Off.

DDC Observer means a Member in Public Practice who is engaged by a Client to provide Professional Services as an observer to a Due Diligence Committee but who will not participate as a DDC Member and will not sign or be a party to any collective reports or documents issued by the Due Diligence Committee. As an observer a Member will:

- attend one or more meetings of the Due Diligence Committee but not undertake any due diligence enquiries or have reporting obligations to the Client or to the Due Diligence Committee;
- attend one or more meetings of the Due Diligence Committee and undertake due diligence enquiries in relation to Financial Information and/or Other Specific Information and provide a report to the Client and/or the Due Diligence Committee. In certain circumstances, depending on factors such as timing and the scope of the Engagement, the Member may prepare a Due Diligence Sign-Off.

Reporting Person means a Member in Public Practice who is engaged by a Client to provide Professional Services and report to the Client and its Due Diligence Committee on a specific issue or area of enquiry, which has been identified by the Client or the Due Diligence Committee. A Reporting Person may also be a DDC Member or DDC Observer.

Due Diligence Sign-Off means the letter or other appropriate written communication issued by a DDC Member or in certain cases a DDC Observer in connection with a Public Document when reporting to a Client and its Due Diligence Committee on the conclusions arising from the procedures conducted by a DDC Member or DDC Observer on Financial Information and/or Other Specific Information.

The recognition that a Member in Public Practice can perform these roles in isolation or can perform the role of Reporting Person in conjunction with either the role of DDC Member or DDC Observer is a fundamental premise of APES 350.

In addition the definitions of "Assurance Client", "Assurance Engagement", "Audit Client" and "Audit Engagement" have been updated in line with the revised *Code of Ethics for Professional Accountants* issued in July 2009 by the International Ethics Standards Board for Accountants (IESBA).

Role of the DDC Observer (Scope and application and other sections)

Respondents noted that, while APES 350 ED addressed the professional and ethical obligations of a Member in Public Practice who acts in the capacity of a DDC Member, it did not clearly describe the role of the Member who is acting in the

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capacity of a DDC Observer. Respondents commented that Members in Public Practice may undertake Engagements as a DDC Observer in a due diligence process and that APES 350 should clearly address the extent of professional obligations of a Member acting in this capacity.

In terms of the distinction between a DDC Member and a DDC Observer, the key distinction is that the DDC Observer does not have the same responsibilities as a DDC Member. The DDC Observer will not participate in the decisions of the DDC nor sign the collective report of the DDC to the Client on the overall appropriateness of the due diligence process and the content of the Public Document. In some instances the role of a DDC Observer may be very limited and will not entail any formal reporting.

APESB considered this issue and determined to make amendments in the scope and application, definitions and other applicable sections of APES 350 to clarify the role of the DDC Observer. The Due Diligence Sign-Off in Appendix 1 of APES 350, and the content requirements for a Due Diligence Sign-Off set out in paragraph 7.3, have been amended to permit a Member acting in the capacity of DDC Observer to provide a Due Diligence Sign-Off, but only after considering the scope of procedures performed as required by paragraphs 5.14, 7.1 and 7.2.

Member's obligations to consider threats to the fundamental principles of the Code (paragraph 3.5¹)

Respondents noted that in the context of providing Professional Services to a Client which comprise participating in and/or reporting to a DDC, there can be threats to the fundamental principles of APES 110 *Code of Ethics for Professional Accountants* (the Code) (for example, objectivity or professional competence) that require consideration prior to accepting an appointment to undertake a role to perform a Professional Service. Accordingly, a new requirement has been included in APES 350 for a Member to consider threats to the fundamental principles of the Code and to apply appropriate safeguards to eliminate the threats or reduce them to an acceptable level prior to accepting an Engagement to perform Professional Services for a Client which comprise participating in and/or reporting to a DDC as a DDC Member, DDC Observer or Reporting Person in connection with a Public Document.

In addition, a new paragraph 3.7 has been included to remind Members in Public Practice of their mandatory obligations to comply with the applicable independence requirements of the *Corporations Act 2001* when they undertake Professional Services for Audit Clients. A further related amendment has been incorporated into paragraph 3.8 for a Member in Public Practice to consider applicable independence obligations when the Client is a listed or disclosing entity in Australia or a foreign jurisdiction.

¹ Paragraph numbering reflects the numbering in APES 350 and may not reflect APES 350 ED.

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Professional competence and due care (paragraphs 3.13 – 3.15)

A respondent was concerned whether these paragraphs implied that a Member in Public Practice must obtain a second opinion on information and reports provided to the DDC by other advisers in the DDC process. The intention of these paragraphs was to mandate where the Member in Public Practice relied on other experts to assist in the Member's work that the Member must properly assess the objectivity and competence of the expert and make adequate disclosures in the reports prepared by the Member. Accordingly, amendments were made to clarify this issue.

Confidentiality (paragraph 3.19)

Respondents were of the view that some of the guidance in respect of confidentiality proposed in APES 350 ED was not feasible as in DDC Engagements it is necessary to share Client information between professional advisers and the Client expects this to occur. Accordingly, APESB has revised paragraph 3.19 to acknowledge this.

Professional Engagement and other matters (paragraphs 4.3 – 4.5)

Respondents were of the view that the requirements of APES 350 ED could be read in a manner that implied that a Member should decline an Engagement where professional responsibilities in addition to those included in the original Engagement document are subsequently requested to be undertaken. Some respondents noted that additional responsibilities may be described in the due diligence planning memorandum or minutes of DDC meetings and that APES 350 should not preclude the Member in Public Practice from undertaking these additional responsibilities.

As this was not the intent of these paragraphs APESB has made amendments to improve the clarity of APES 350 as well as to state that where additional tasks are assigned to a Member in Public Practice, and they are acceptable to both the Member and the Client, then the Member must either issue an addendum to the Engagement document or issue a revised Engagement document.

Importantly, in accordance with APES 305 *Terms of Engagement*, a Member in Public Practice must document and communicate the terms of Engagement with the Client through an Engagement document. The professional obligations of a Member in Public Practice cannot be determined by the due diligence planning memorandum or minutes of DDC meetings which are not documents that the Member controls.

Roles and obligations of a Member in Public Practice in a due diligence process in connection with a Public Document (paragraphs 5.1 – 5.8)

Paragraph 5.1 of APES 350 ED described various roles that may be undertaken by a Member in Public Practice in the due diligence process in connection with a Public Document. This has been revised in APES 350 to be in line with the three primary roles of DDC Member, DDC Observer and Reporting Person. Further, examples of reports a Member in Public Practice may provide when not acting in one of these three primary roles have been included to indicate that a Member may

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provide other Professional Services without undertaking one of the three primary roles.

Paragraph 5.2 of APES 350 has been amended to include the three primary roles undertaken by a Member in Public Practice in relation to a DDC and to state that a Member must specify in the Due Diligence Sign-Off the Financial Information and/or Other Specific Information relevant to the Public Document that the Member has performed procedures on, and the nature of those procedures.

Further, Members who accept an Engagement to report to a DDC must only report or advise on matters where they have the necessary expertise (paragraph 5.4). For example, where a Client engages an accounting firm to provide legal services, the firm must only provide those services if the firm has suitably qualified lawyers (new paragraph 5.6).

Reporting by Members (paragraphs 5.4 – 5.5 and 5.7 – 5.8)

A respondent noted that a Member in Public Practice who advises on, or provides content for, a Public Document must ensure that the Member's contribution meets the relevant disclosure standard imposed by law. The respondent was of the view that it is appropriate for a Member in Public Practice to confirm to the Client and its DDC that the Member's advice on, or content provided for, a Public Document meets the relevant disclosure standard imposed by law. According to the respondent, a failure by a Member in Public Practice to provide an express confirmation in relation to the Member's work product will mean that others involved in the preparation of a Public Document potentially have inadequate assurance that the Member's work product complies with the relevant disclosure standard. The respondent contended that the effect of this failure by a Member in Public Practice to provide an express confirmation in relation to the Member's own work is to transfer risk on the issue of compliance to others involved in the preparation of the Public Document.

APESB considered this issue and noted that:

- the determination of the nature and quantum of information included in a Public Document is a decision for the Client in collaboration with its DDC. It follows that the determination concerning, for example, the number of years of Statements of Financial Position and Statements of Financial Performance included in a Public Document are decisions for the Client. This Financial Information is not the "work product" of a Member in Public Practice, but the "work product" of the Client. Any Due Diligence Sign-Off provided by a Member in Public Practice will be in respect of the disclosed Financial Information and not whether, for example, the Statements of Financial Position and Statements of Financial Performance for additional years should be included.
- in relation to the respondent's submission that Members in Public Practice should provide a sign-off that there are no omissions of information required by the *Corporations Act 2001* in a Public Document, there is no accepted or approved disclosure framework against which a Member can assess the appropriateness and adequacy of those disclosures relative to the general disclosure

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requirements of the *Corporations Act 2001*, in particular those set out in section 710 of that Act; and

- unlike the disclosure requirements for a financial report, which are clearly set out in Accounting Standards and the *Corporations Act 2001*, the disclosure requirements of the *Corporations Act 2001* in relation to a Public Document are general in nature. A combination of skills, knowledge and expertise is therefore required to determine the nature and quantum of information to be disclosed in a Public Document. A Member in Public Practice will not possess all those skills and all the necessary knowledge and expertise to enable the Member to report as proposed by the respondent, except in conjunction with the other members of a DDC.

Accordingly, APESB is of the view that the responsibility for determining or advising on whether the Financial Information disclosed in a Public Document is appropriate and adequate to meet the relevant disclosure standard should not rest with the Member in Public Practice in isolation. This is the responsibility of the Client and its DDC and accordingly this sign-off on the content of the Public Document should only be provided by the DDC as a whole rather than in the Member's Due Diligence Sign-Off.

Member's responsibilities in respect of drafting and verification (paragraphs 5.10 – 5.13)

APES 350 ED prohibited Members in Public Practice from assisting in drafting or verifying parts of a Public Document with the exception of the reports issued by the Member. Respondents noted that, subject to applicable independence and professional requirements, in certain instances Members in Public Practice are engaged to assist Clients in drafting (for example, tax implications for investors) or verifying parts of a Public Document.

APESB considered respondents comments and has amended paragraph 5.10 to state that Members in Public Practice must not prepare the Financial Information, or the disclosures relating to that information, which is the subject of their Due Diligence Sign-Off.

In respect of verification, paragraphs 5.12 and 5.13 have been amended to state that where a Member in Public Practice agrees to assist in a Client's verification process, the Member must agree the specific procedures to be undertaken with the Client and should undertake an agreed-upon procedures Engagement. However, as noted in paragraph 5.13 the primary responsibility for verification rests with the Client who is responsible for the information and in the best position to know whether there is any new or additional information that may affect the verification of its Financial and/or Other Specific Information.

Reporting and Due Diligence Sign-Off (paragraphs 7.1 – 7.3 and Appendix 1)

New paragraphs 7.1 and 7.2 have been incorporated into APES 350 requiring a Member in Public Practice to consider the following matters before providing a

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Due Diligence Sign-Off and, in particular, before making the statements set out in paragraph 7.3(k):

- whether the scope of procedures undertaken is sufficient and appropriate to support the provision of a Due Diligence Sign-Off;
- any scope limitations;
- whether all material matters which arose during the course of the Member's work have been appropriately addressed by the Client and its DDC; and
- the passage of time between the performance of the procedures by the Member and the proposed provision of the Due Diligence Sign-Off and whether those procedures were undertaken pursuant to a different unrelated Engagement.

Member's responsibilities in respect of draft documents (paragraphs 7.4 and 7.5)

APES 350 ED stated that a Member in Public Practice must only provide a Due Diligence Sign-Off in respect of Public Documents that the Member understands to be in a final form. Respondents noted that draft Public Documents are used as briefing documents to seek financial support from potential investors and that there should be some flexibility for this commercial practice to continue.

APESB considered this issue and has determined that in certain circumstances a Member in Public Practice may provide a provisional Due Diligence Sign-Off provided the Member states in the provisional sign-off:

- the assumptions or qualifications upon which the provisional Due Diligence Sign-Off is based;
- the specific draft of the Public Document to which it relates; and
- that it is subject to change.