

AGENDA PAPER

Item Number: 7
Date of Meeting: 16 November 2020
Subject: Proposed revised APES 305 *Terms of Engagement*

Action required **For discussion** **For noting** **For information**

Purpose

To:

- provide the Board with an update on the submissions received on the APES 305 *Terms of Engagement* (APES 305) Exposure Draft 02/20 (APES 305 ED 02/20); and
- obtain the Board's approval, subject to the Board's review comments and editorials, to issue the proposed revised APES 305; and
- obtain the Board's approval of Technical Staff's proposed way forward in relation to APES GN 30 *Outsourced Services* (APES GN 30).

Background

Technical Staff provided an update to the Board on outsourcing in [Agenda Item 2](#) of the June 2020 Board meeting, including background of the APES GN 30 project to date. The Board approved at the June 2020 meeting the Exposure Draft on proposed revisions to [APES 305 ED 02/20](#) and the main proposed amendments therein included:

- Definitions (from APES GN 30) for cloud computing, material business activity, outsourced service, outsourced service provider, outsourcing and outsourcing agreement;
- a requirement paragraph on members' obligations under Subsection 114 *Confidentiality* of APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code);
- application material highlighting the impact on risk and management of the client's confidential information when utilising outsourced services or cloud computing and reference to APES GN 30 guidance;
- a requirement to document and communicate the details of the outsource service provider, the geographic location of where the outsourced service will be performed and the nature and extent of outsourced services; and

- application material to document and communicate the details of the cloud computing provider (that is not an outsourced service), the geographic location of where the cloud computing will be performed, where client data will be stored and the nature and extent of cloud computing.

At the request of the Board, subsequent to the June 2020 Board meeting, Technical Staff undertook further research and refined the definition of 'Cloud Computing', which was approved out of session and incorporated into APES 305 ED 02/20 before it was issued.

[APES 305 ED 02/20](#) was issued for public comment on 14 July 2020, with comments due by 15 October 2020.

Matters for Consideration

Submissions Received on APES 305 ED 02/20

APESB received submissions from the following four stakeholders:

- Chartered Accountants Australia and New Zealand (CA ANZ);
- CPA Australia;
- Ernst & Young (EY); and
- Ms Liz Giust of Qualitas Consulting (Qualitas).

The submissions and Technical Staff analysis are included in General and Specific Tables attached as Agenda Items 7(a) and 7(b). The significant issues raised by stakeholders are summarised below, including references to the Specific Comments (SC) in Agenda Item 7(b), which provide further detail and analysis.

Three submissions were generally supportive of the proposed amendments in APES 305 ED 02/20 (CA ANZ, CPA Australia and Qualitas) with some qualifying comments discussed below. EY made several specific comments included in Agenda Item 7(b) and summarised below.

One stakeholder noted proposed paragraphs 3.5 to 3.7 create an additional regulatory burden over and above Australian Privacy Principles (APPs) and the Board should consider whether the cost of compliance outweighs the benefits (SC3). Technical Staff note that only proposed paragraph 3.6 creates a mandatory requirement, which does include additional disclosure obligations to APPs. However, it is consistent with the Board's desire to ensure Those Charged with Governance of clients (Boards and audit committees) understand the nature of outsourced services utilised, management and security of client confidential information, and promote quality and ethical professional services.

A submission questioned whether proposed guidance paragraph 3.7 on disclosures of the use of cloud computing (that is not an outsourced service) should be elevated to a requirement (SC5). Technical Staff do not agree that this should be made a requirement. However, members could do so voluntarily or if a client specifically requested the additional details. Further, maintaining this as guidance is consistent with the Tax Practitioners Board (TPB) Practice Note TPB(PN) 1/2017 [Cloud computing and the Code of Professional Conduct](#).

A stakeholder raised concerns that the depth and breadth of the application of the proposed revisions on cloud computing require clarification.

The stakeholder also noted that the examples in APES GN 30 need to be updated and guidance should be provided whether various software and cloud-based services need be mandatorily disclosed under proposed paragraph 3.6, voluntarily disclosed under the proposed paragraph 3.7 or not at all (SC6 to SC12).

Technical Staff note that proposed paragraph 3.6 requires disclosures about the utilisation of outsourced services, which involve a material business activity being an activity that, if disrupted, would significantly impact quality, timeliness or scale of professional services provided. Further, material business activities exclude the internal activities of a firm, such as record storage or software application hosting.

Technical Staff are of the view that many of the examples provided by this stakeholder may meet the definition of cloud computing; however, they may not necessarily meet the definition of material business activities. This determination depends on the specific circumstances of the engagement and application of professional judgement. Where it is not a material business activity, the firm would need to use professional judgement as to whether the use of cloud computing should be disclosed under proposed paragraph 3.7 of APES 305. Technical Staff believe the proposed revisions listed below will make such assessments easier for members.

Technical Staff agree that the examples in APES GN 30 should be reviewed and updated and that some of the examples provided by stakeholders could be considered for inclusion in APES GN 30 (refer to further discussion below).

A stakeholder raised concerns about the requirement in proposed paragraph 3.6 of APES 305 to disclose the 'nature and extent' of outsourced services as this may not be known at the outset of, or may change throughout, an engagement and recommend this be removed (SC9, SC14 & SC15).

Technical Staff believe this information should generally be readily available to firms based on existing guidance and requirements. For example, paragraphs 4.4 and 4.6 of APES 305 provide guidance to members about matters to be considered for inclusion in the engagement document about the scope and the relative responsibilities of the member, the client and any third party. Paragraph 5.2 of APES 305 helps members determine whether to reissue or amend an engagement document, including where there are significant changes in the engagement or professional services. Further, as noted above, the requirement in proposed paragraph 3.6 (and guidance in proposed paragraph 3.7) is an extension of existing APP obligations.

A stakeholder recommends that the engagement agreement should more generally state that client information may be provided to external service providers but that the member remains responsible for maintaining the confidentiality of client information (SC11 & SC13). Technical Staff note that paragraph 4.6 of APES 305 provides guidance to members about matters to be considered for inclusion in the engagement document regarding the member's relative responsibilities, including reference to relevant confidentiality requirements' in paragraph 4.6(a).

One stakeholder suggests that paragraph 5.2 of APES 305, which provides assists members to determine whether to reissue or amend an engagement document, should be amended to include specific reference to when there is a change in outsourced service providers. Technical Staff believe that paragraph 5.2 is not designed to be exhaustive and including a specific reference could result in the reverse and undesired effect of limiting the information provided to that in relation to outsourced service providers.

Proposed Revised APES 305

Technical Staff propose the following amendments to APES 305 subsequent to APES 305 ED 02/02:

- removing 'Member and/or the' from the last sentence of the definition of cloud computing to make clear that for the purposes of APES 305 it is concerned with the client's data and information (SC20 & SC 21);
- refining the last sentence of the definition of material business activity to make it clearer that it excludes internal operational activities (i.e., not part of the core service) that have been outsourced (SC9 & SC11);
- adding to the footnote to the definition of outsourced services that engagements which are subject to ASA 600 *Special Considerations – Audits of a Group Financial Report* are not considered to be an outsourced service (SC14);
- remove specific reference in paragraph 3.4 of APES 305 to a specific part of Subsection 114 of APES 110 to avoid any doubt that the proposed paragraph limits the application of Subsection 114 of APES 110 (SC1);
- amend the reference to 'Client data' in proposed paragraph 3.7 to 'Client's confidential information' to be consistent with proposed paragraphs 3.4 and 3.5 (refer SC13);
- remove the reference to nature and extent in proposed paragraph 3.7 of APES 305 and make the paragraph clearer (SC20 & SC 21);
- change the reference in subparagraph 4.6(c) from 'any third party' to 'any third party including Outsourced Service Providers' to highlight to members that use such services to consider including the relative responsibilities in the engagement document (refer SC16); and
- amend the wording in paragraph 4.9 to clarify the importance of ownership of documents and data and that electronic data can be an output of the engagement as well as being provided by the client (refer SC17).

A marked-up version of the proposed revised APES 305 is attached at Agenda Item 7(c).

Proposed Effective Date of APES 305

APES 305 ED 02/20 proposed that the revised standard be effective for engagements commencing on or after 1 July 2021. One submission requested additional transitional relief in respect of engagement agreements substantially drafted before the proposed operative date (refer SC22). Technical Staff do not agree that such transitional relief is required. The operative date drafting is consistent with other APESB pronouncements (excluding the Code and quality control for Firms) issued over the last decade.

However, in undertaking the analysis of the submissions on APES 305 02/20 Technical Staff note that paragraphs 5.1 and 5.2 of APES 305 may result in a significant number of members updating engagement documents concerning recurring engagements. One factor in determining whether to update the terms of engagement is if there has been a significant change to a professional standard. Therefore, if the member utilises outsourced services, they will likely need to update the terms of engagement for recurring engagements based on the proposed revisions to APES 305.

As such, and in conjunction with the impacts of COVID-19, Technical staff recommend that the Board consider whether the proposed changes to APES 305 be changed to become **“effective for engagements commencing on or after 1 January 2022”**.

APES GN 30

Subject to the Board approving the proposed revised APES 305, it will be necessary to revise APES GN 30 as some of the guidance material therein will be in APES 305 and the definitions of cloud computing and material business activity require updating.

Technical Staff also propose reviewing the examples in APES GN 30 at the same time to ensure they are contemporary and to consider the inclusion of additional examples from the submissions received on APES 305 ED 02/20.

As such, Technical Staff propose to prepare an Exposure Draft for APES GN 30 for consideration at the March 2021 Board meeting.

Way Forward

Subject to the Board’s approval Technical Staff propose the following way forward:

- issue the proposed revised APES 305 (Agenda Item 7(c)) in November/December 2020;
- review and update APES GN 30 and the examples therein between December 2020 and February 2021, in respect of material now covered in APES 305, changes to definitions and examples from submissions received on APES 305 ED 02/20; and
- prepare an Exposure Draft for APES GN 30 to be considered at the March 2021 Board meeting.

Recommendations

The Board:

- note the update on the submissions received on the APES 305 ED 02/20;
- approve, subject to the Board’s review comments and editorials, the issue of proposed revised APES 305; and
- approve Technical Staff’s proposed way forward in relation to APES GN 30.

Materials presented

Agenda Item 7(a)	ED 02/20 General Comments Table APES 305
Agenda Item 7(b)	ED 02/20 Special Comments Table APES 305
Agenda Item 7(c)	Proposed Revised APES 305

Author Jon Reid

Date 10 November 2020