

Professional & Ethical Considerations relating to due-diligence sign-offs for Low Doc Offerings

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This publication is not a substitute for reading the full text of APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document*, APES 110 *Code of Ethics for Professional Accountants* and other relevant APESB pronouncements.

Purpose

This publication contains matters Members in Public Practice who issue due diligence sign-offs in connection with Low Doc offerings may consider. The publication could also assist others involved in a Low Doc offering to understand why a due diligence sign-off may not be able to be provided in certain circumstances. The determination of whether to issue a due diligence sign-off is a matter of professional judgement having regard to paragraph 1.10 of APES 350 *Participation by Members in Public Practice in Due Diligence Committees in connection with a Public Document* (APES 350)¹.

Topics discussed in this Publication

- Reasons for Low Doc offerings
- Key ethical considerations to consider in applying paragraph 1.10 of APES 350 and the Code:
 - Features of a Low Doc engagement necessary to be able to issue a due diligence sign-off; and
 - Features of a Low Doc engagement that would preclude issuing a due diligence sign-off
- Key Messages
- Examples
- Glossary

¹ Originally issued December 2009, subsequently amended in March 2011 and revised in August 2015

Introduction

APES 350 specifies a Member in Public Practice's professional and ethical responsibilities when providing certain Professional Services to a Client, namely those services which consist of participating in and/or reporting to a Due Diligence Committee as a DDC Member, DDC Observer or Reporting Person, in connection with a Public Document.²

Additionally, paragraph 1.10 of APES 350 states that "The Standard should be applied to the extent practicable where a Member in Public Practice provides Professional Services to a Client which comprise participating in and/or reporting to a Due Diligence Committee as a DDC Member, DDC Observer or Reporting Person in connection with an Engagement which **is not in connection with a Public Document.**" *[emphasis added]*

Low Doc Offerings

In Australia, Low Doc offerings are security offerings undertaken by entities whose securities are already listed and are characterised by the preparation and issue of a document other than a Public Document. Generally, the document contains limited financial and other information and takes the form of a presentation-style document. The capital raising may be a standalone transaction, in conjunction with an acquisition or for refinancing.

Low Doc offerings are not governed by the same requirements and disclosure obligations as those offerings that require the issue of Public Documents. Sections 708, 708AA and 1012AA of the *Corporations Act 2001* permit an entity to make an offer of quoted securities and quoted interests without a Disclosure Document or Public Disclosure Statement (PDS) where the offer is a rights issue or placement.

Since 2007 ASIC has permitted ASX-listed companies to undertake 'low doc' rights issues by way of releasing to the market a 'cleansing notice' at the time of announcing the rights issue or placement, instead of issuing a prospectus.

Low Doc equity raisings are typically undertaken by a listed company in a limited time frame. The work undertaken by a Member in Public Practice can vary significantly from one Low Doc engagement to another.

If a cleansing notice is defective, either because it contains a misleading or deceptive statement or omits relevant information, those involved with the offer (including the directors) may be liable for any loss suffered by investors. There is no 'Due Diligence' defence for a defective cleansing notice. Similarly, there is no 'Due Diligence' defence for any defective disclosure that is made by a company in connection with a placement.

² A Public Document is defined in APES 350 to mean a Disclosure Document, Product Disclosure Statement (both as defined in the *Corporations Act 2001*) or other documentation provided to shareholders, unit holders or holders of a relevant interest in an entity (or which is provided to management of an entity) in relation to a scheme of arrangement under Part 5.1 of the *Corporations Act 2001* or a takeover or compulsory acquisition under Chapter 6 of the *Corporations Act 2001*.

For the purposes of this document, a Low Doc offering as described above is considered to be one to which paragraph 1.10 of APES 350 could apply, in which many of the elements of an APES 350 engagement are present, however, the engagement is not one which is in connection with a public document.

Features of a Low Doc Engagement necessary to be able to issue a due diligence sign-off

In order for a Member in Public Practice or Firm to consider issuing a due diligence sign-off in respect of a Low Doc offering it is considered that all or most of the following conditions³, or a combination thereof, should be present:

- Financial Information in respect of which the Member in Public Practice or Firm is in a position to issue an unqualified review conclusion in accordance with ASAE 3450 *Assurance Engagements involving Corporate Fund Raisings and/or Prospective Financial Information* (ASAE 3450) or other similar standards on Assurance Engagements. These circumstances may generally include:
 - the base Financial Information having been recently (or concurrently) subject to audit by the same Firm or another Firm.
 - the Client allowing for sufficient time, budget and resources for the Firm to perform the required assurance procedures in accordance with ASAE 3450.
- Financial systems and processes at the Client and target entity, where applicable, with which the Member in Public Practice or Firm is familiar and is confident that these systems and processes are able to provide accurate and reliable Financial Information.
- A robust due diligence process being undertaken by a Due Diligence Committee comprising experienced management and Board representation and receiving input from advisers with the appropriate expertise (either as Members/Observers and/or Reporting persons).
- If the Member is an observer of the DDC, their role is not too dissimilar to a role undertaken in respect of a Public Document, including attendance at DDC meetings and having sufficient time and resources to be able to obtain appropriate management representations and complete their assurance procedures in accordance with ASAE 3450.

In determining whether these features are present, a Member in Public Practice will need to make qualitative assessments of the particular circumstances of the Engagement, for example in determining how robust the due diligence process is. In this regard, the greater the similarity with the process for an Engagement in connection with a Public Document, the more satisfied the Member is likely to be about the appropriateness of the application of APES 350 to a non-Public Document Engagement.

³ This list is not exhaustive and whether it is appropriate to accept an Engagement that includes providing a due diligence sign-off is a matter in relation to which the Member in Public Practice will exercise professional judgement.

Features of a Low Doc engagement that would preclude issuing a due diligence sign-off

If any of the following conditions are present, individually or in combination, a Member in Public Practice or Firm should not consider issuing a due diligence sign-off:

- Financial Information is not prepared in accordance with an applicable financial reporting framework and/or the Member in Public Practice or Firm is **not** in a position to issue an unqualified review conclusion in accordance with ASAE 3450 or other similar Standards on Assurance Engagements.
- The urgency of the requirement for additional equity to be raised via a Low Doc offering is such that the offer is made in an unduly short time frame (for example, a matter of days rather than weeks) and the involvement of and participation by the Client's management, directors, any other advisers, and/or the Member or Firm, in any due diligence process is unduly limited by that time frame.
- The time frame dictates and /or the Client determines that the Firm is to only perform a limited scope of work, (i.e. limited specific due diligence enquiries or Agreed-Upon Procedures engagement undertaken in accordance with ASRS 4400 *Agreed-Upon Procedures Engagements to Report Factual Findings* (ASRS 4400)).
- The formal due diligence process (if any) and meetings of the DDC are limited in number, duration and scope.
- Financial disclosures in the Low Doc offering materials are limited in form (for example a small number of non GAAP measures or ratios) and not conducive to the provision of a review opinion under ASAE 3450.

Key Messages

- Due diligence sign-offs should only be provided when the following requirements, at a minimum, are met:
 - assurance procedures can be performed, and an assurance conclusion provided, in accordance with ASAE 3450 or similar assurance standards;
 - there is an appropriately robust Due Diligence process; and
 - sufficient time, resources and expertise have been allocated to the process by the Client, the Client's other advisers, and the Member in Public Practice or Firm.
- Members in Public Practice must exercise their professional judgement when determining whether it is appropriate to prepare and issue a due diligence sign-off having regard to paragraph 1.10 of APES 350 in a Low Doc Engagement.

Examples

The examples provided set out various scenarios of Low-doc offerings and considers whether it might be appropriate to issue a due diligence sign-off having regard to paragraph 1.10 of APES 350.

Members in Public Practice are cautioned that the determination of whether to issue an APES 350 due diligence sign-off is a matter of professional judgement, based on the particular facts and circumstances. These examples are provided for illustrative purposes only and are not intended to be, and cannot be, all inclusive. The examples are not a substitute for reading the full text of APES 350, APES 110 or other applicable APESB or AUASB pronouncements. In all of the examples presented below it is assumed that there are no unmentioned facts which would be relevant to the consideration as to whether a due diligence sign-off can be issued.

Example 1

Facts

An Audit Client is undertaking a rights issue shortly after the issuance of the audit report in relation to its financial statements. The Audit Client has established a robust due diligence process. The Firm is engaged to perform limited assurance procedures in accordance with ASAE 3450 in respect of the pro-forma Financial Information. The Firm believes they will be able to complete the required procedures within the time frame required by the Audit Client.

Analysis

In this circumstance, the Firm has recently audited the Financial Information and has been engaged to perform limited assurance procedures in accordance with ASAE 3450. There is a robust due diligence process in place and the Firm has been allocated sufficient time and resources to complete the required procedures.

Conclusion

As the Firm is able to issue an unqualified review conclusion in accordance with ASAE 3450, and there is an adequate due diligence process, in this instance, the Firm is able to provide a due diligence sign-off having regard to paragraph 1.10 of APES 350 in relation to the pro-forma Financial Information.

Example 2

Facts

An Audit Client of the Firm is undertaking a rights issue shortly after the issuance of the audit report in relation to its financial statements. The Audit Client has established a robust due diligence process. The Audit Client has determined that it does not require the Firm to perform a review of

its pro-forma Financial Information in accordance with assurance standards, and instead engages the Firm to perform certain limited Agreed-Upon Procedures. The Firm believes they will be able to complete the required procedures within the time frame required by the Audit Client.

Analysis

In this circumstance, although the Firm has recently audited the Financial Information of the Audit Client, it has been engaged to perform Agreed-Upon Procedures in respect of the pro-forma Financial Information. While the due diligence process may be robust, and there is sufficient time and resources to complete required procedures, assurance procedures are not being performed in this instance.

Conclusion

As the Firm has not been requested to issue a review conclusion in accordance with ASAE 3450, in this instance, the Firm is not able to provide a due diligence sign-off having regard to paragraph 1.10 of APES 350 in relation to the pro-forma Financial Information.

Example 3

Facts

An Audit Client is proposing to raise capital via a low-doc process to finance the proposed acquisition of a target entity based in another jurisdiction. The Audit Client has established a robust due diligence process and engaged an Australian based Firm. A different Firm based in the other jurisdiction has been engaged to undertake an acquisition due diligence engagement in relation to the target entity, which applies the Generally Accepted Accounting Principles (GAAP) of the other jurisdiction in preparing its Financial Information. The Audit Client applies Australian Accounting standards in preparing its Financial Information.

The target entity's Financial Information is to be incorporated into the merged group's pro forma Financial Information. However, the Australian based Firm does not have access to the books and records of the target entity. The Australian based Firm has been allocated sufficient time to complete the required procedures within the period required by the Audit Client.

Analysis

There is a robust due diligence process in place and the Australian based Firm has been allocated sufficient time and resources to complete the required procedures. However, the Australian based Firm does not have access to the books and records of the target entity. That entity's Financial Information will form part of the merged entity's pro-forma merged Financial Information. While the Firm may be in a position to perform assurance procedures over the Australian entity it is unable to do so in respect of the target entity.

Conclusion

As the Firm has not been engaged to perform assurance procedures in respect of the target entity, it is unable to issue an unqualified review conclusion in accordance with ASAE 3450. In this instance the Firm is not able to provide a due diligence sign-off having regard to paragraph 1.10 of APES 350 in relation to the merged group's pro-forma Financial Information.

Example 4

Facts

A Client is undertaking a rights issue and placement to fund an acquisition. The Firm is requested to perform a review of certain forecast Financial Information in accordance with ASAE 3450 and prepare a due diligence sign-off having regard to paragraph 1.10 of APES 350. While the capital raising will occur through a low doc process, the Client is implementing a rigorous due diligence process in connection with the proposed disclosures. The timetable for the low doc process is sufficient to enable the performance of the necessary assurance procedures and the gathering of sufficient evidence. The nature of the Client's business is based on long term contracts which facilitates the efficient gathering of supporting evidence for the vast majority of key forecast assumptions.

Analysis

The Firm has been engaged to perform a review engagement in respect of the forecast Financial Information in accordance with ASAE 3450. The Client has implemented a robust due diligence process which includes providing adequate time and resources to enable the Firm to perform the necessary assurance procedures.

Conclusion

As the Firm has been engaged to and is able to issue an unqualified review conclusion in accordance with ASAE 3450, in this instance the Firm is able to provide a due diligence sign-off having regard to paragraph 1.10 of APES 350 in relation to the pro-forma forecast Financial Information.

Example 5

Facts

The Client is undertaking a rights issue and placement to fund an acquisition. The Client has established a robust due diligence process. The Client has engaged the Firm to undertake acquisition due diligence procedures in relation to the target. The Firm believes they will be able to complete the required procedures within the time frame required by the Client. However, the Client subsequently decided to raise additional equity capital to finance the acquisition, and did not want the Firm to perform additional assurance procedures in relation to the target's Financial Information.

Analysis

The Client has implemented a robust due diligence process and has allocated adequate time and resources to the Firm. While the Firm may be in a position to perform assurance procedures over its Client it has not been retained to do so in respect of the target entity's financial information.

Conclusion

As the Firm has not been engaged to and therefore is unable to perform a review in accordance with ASAE 3450, in this instance the Firm is not able to provide a due diligence sign-off having regard to paragraph 1.10 of APES 350 in relation to the Financial Information of the target.

Glossary

[This section will be shaped by the terms used in the body of the publication that should be defined here. Some of the terms might include:

- *Audit Client;*
- *Cleansing Notice;*
- *Client;*
- *Code;*
- *Disclosure document;*
- *Engagement;*
- *Firm;*
- *Financial Information;*
- *Low Doc;*
- *Public document;*
- *Placement;*
- *Rights issue;*
- *Products Disclosure Statement; and*
- *Prospectus.]*

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