

Fees – Proposed Revisions to Part 4A of the Code (clean version)

PART 4A – INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

SECTION 410

FEES

Introduction

- 410.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.
- 410.2 Fees or other types of remuneration are commonly a significant driver of behavior. In the context of an audit engagement, fees (for both audit engagements and services other than audit) can influence independence of mind and the level of these fees can also adversely impact perceptions of independence from the perspective of a reasonable and informed third party. Therefore, when fees are paid to the firm by the audit client they create threats to independence. The type and level of threat will depend on the nature and level of fees or other types of remuneration. The level of threats to independence, particularly independence in appearance, is generally greater for public interest entities because they have a large number and wide range of stakeholders. However, because a firm is required to be independent when performing audit engagements and have in place a system of quality management that is designed, among other matters, to provide it with reasonable assurance in relation to compliance with independence requirements, threats created when fees are paid by an audit client to the firm will often be at an acceptable level. This section sets out specific requirements and application material relevant to applying the conceptual framework relating to fees charged to audit clients.

Requirements and Application Material

General

- 410.3 A1 Determining the level of fees to be charged to an audit client, whether for audit or other services, is a business decision of the firm taking into account all the facts and circumstances relevant to that specific engagement, including the requirements of professional standards.

Nature and Level of Audit Fees

Level of Audit Fees

- R410.4** A firm shall be satisfied prior to the engagement partner signing the audit report that the level of the audit fee did not compromise the firm's independence and hence its ability to perform the audit in compliance with the fundamental principles, including in accordance with professional standards.
- 410.4 A1 The IAASB's International Standards establish the responsibilities for the firm and the engagement partner with respect to the audit. In particular, irrespective of the fees quoted or charged, [proposed] ISQM 1 requires the firm to establish a system of quality management that addresses appropriately obtaining, developing, using, maintaining, allocating and assigning resources, including human resources, technological resources, and intellectual resources. In addition, [proposed] ISA 220 (Revised) requires the engagement partner to determine that sufficient and appropriate resources are assigned or made available to perform the audit engagement.

Impact of Other Services Provided to an Audit Client

410.5 A1 If a firm agrees to provide audit services at a lower fee because the audit client engages or promises to engage the firm or a network firm for the supply of services other than audit, this creates an intimidation threat and might create a self-interest threat.

R410.6 A firm shall be satisfied that the provision of services other than audit to an audit client did not influence the level of the audit fee.

410.6 A1 The level of the audit fee ordinarily reflects a combination of factors. These include the skills and experience of members of the audit team, the time spent commensurate with the scope and complexity of the audit, the cost of other resources expended in performing the audit, and the firm's competitive position in the market place. The provision of other services to the audit client is not an appropriate factor in determining the level of the audit fee. This is not intended to prevent a firm recognizing that there might be appropriate cost synergies should such services other than audit be provided. However, should such synergies arise they may be reflected in the fees for the services other than audit and not in the audit fee.

Contingent Fees

410.7 A1 Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed. A contingent fee charged through an intermediary is an example of an indirect contingent fee. In this section, a fee is not regarded as being contingent if established by a court or other public authority.

Audit Engagements

R410.8 A firm shall not charge directly or indirectly a contingent fee for an audit engagement.

Assurance Services Provided to an Audit Client

410.9 A1 Paragraph R905.7 in Part 4B – *Independence for Assurance Engagements Other than Audit and Review Engagements* sets out a requirement for contingent fees for assurance services provided to an audit client.

Non-assurance Services Provided to an Audit Client

R410.10 A firm or network firm shall not charge directly or indirectly a contingent fee for a non-assurance service provided to an audit client, if:

- (a) The fee is charged by the firm expressing the opinion on the financial statements and the fee is material or expected to be material to that firm;
- (b) The fee is charged by a network firm that participates in a significant part of the audit and the fee is material or expected to be material to that firm; or
- (c) The outcome of the non-assurance service, and therefore the amount of the fee, is dependent on a future or contemporary judgment related to the audit of a material amount in the financial statements.

410.10 A1 Even if a contingent fee arrangement is not precluded when providing a non-assurance service to an audit client, a self-interest threat might still be created.

410.10 A2 Factors that are relevant in evaluating the level of such a threat include:

- The range of possible fee amounts.
- Whether an appropriate authority determines the outcome on which the contingent fee depends.

- Disclosure to intended users of the work performed by the firm and the basis of remuneration.
- The nature of the service.
- The effect of the event or transaction on the financial statements.

410.10 A3 Examples of actions that might be safeguards to address such a self-interest threat include:

- Having an appropriate reviewer who was not involved in performing the non-assurance service review the work performed by the firm.
- Obtaining an advance written agreement with the client on the basis of remuneration.

Total Fees – Ratio of Fees for Services Other than Audit to Audit Fee

410.11 A1 When a large proportion of fees charged by the firm or network firms to an audit client is generated by providing services other than audit, the risk of losing the engagements other than the audit creates self-interest and intimidation threats.

410.11 A2 Factors that are relevant in evaluating the level of such threats include:

- The ratio of fees for services other than audit to the audit fee.
- The relationship to the audit client of the related entities for which the services other than audit are provided.
- The nature, scope and purposes of the services, including whether they are recurring services.
- The qualitative and quantitative significance of the client to the firm.
- The operating structure and the compensation arrangements of the firm and the network.

410.11 A3 An example of an action that might be a safeguard to address such self-interest or intimidation threats is having an appropriate reviewer who did not take part in the audit or the other engagements review the relevant audit work.

Total Fees – Relative Size

All Audit Clients

410.12 A1 When the total fees generated from an audit client by the firm expressing the audit opinion represent a large proportion of the total fees of that firm, the dependence on that client and concern about losing the client create self-interest and intimidation threats.

410.12 A2 In calculating the total fees of the firm in this section, the firm might use financial information available from the previous financial year and estimate the proportion based on that information.

410.12 A3 Factors that are relevant in evaluating the level of such threats include:

- The qualitative and quantitative significance of the audit client to the firm.
- Whether the firm is expected to expand such that the significance of the client is likely to reduce.

410.12 A4 Examples of actions that might be safeguards to address such self-interest and intimidation threats include:

- Increasing the client base in the firm to reduce dependence on the audit client.
- Reducing the extent of services other than audit provided to the client.

410.12 A5 Self-interest or intimidation threats are also created when the fees generated by a firm from an

audit client represent a large proportion of the revenue of one partner or one office of the firm.

410.12 A6 Factors that are relevant in evaluating the level of such threats include:

- The qualitative and quantitative significance of the audit client to the partner or office.
- The extent to which the compensation of the partner, or the partners in the office, is dependent upon the fees generated from the client.

410.12 A7 Examples of actions that might be safeguards to address such self-interest and intimidation threats include:

- Reducing the extent of services other than audit provided by the partner or office to the audit client.
- Ensuring that the compensation of the partner is not significantly dependent on the fees generated from the client.
- Having an appropriate reviewer who did not take part in the audit engagement review the audit work.

Audit Clients that are Not Public Interest Entities

R410.13 When total fees from an audit client that is not a public interest entity represent, or are likely to represent, more than 30% of the total fees received by the firm for five consecutive years, the firm shall determine whether either of the following actions might be a safeguard to address the threats created, and if so, apply it:

- (a) Prior to the audit opinion being issued on the fifth year's financial statements, have a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, or a professional body review the fifth year's audit work; or
- (b) After the audit opinion on the fifth year's financial statements has been issued, and before the audit opinion being issued on the sixth year's financial statements, have a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, or a professional body review the fifth year's audit work.

R410.14 If the total fees described in paragraph R410.13 continue to exceed 30%, the firm shall each year determine whether either of the actions in paragraph R410.13 applied to the relevant year's engagement might be a safeguard to address the threat created by the total fees received by the firm from the client, and if so, apply it.

R410.15 In the case of a joint audit, where the circumstances addressed by paragraph R410.13 apply to only one of the firms expressing the audit opinion, the involvement of the other firm in the joint audit may be regarded as an action equivalent to that in paragraph R410.13 (a).

Audit Clients that are Public Interest Entities

R410.16 When the total fees from an audit client that is a public interest entity and its related entities represent, or are likely to represent, more than 15% of the total fees received by the firm for two consecutive years, the firm shall determine whether, prior to the audit opinion being issued on the second year's financial statements, an engagement quality review performed by a professional accountant who is not a member of the firm expressing the opinion on the financial statements ("pre-issuance review") is a safeguard to address the threat, and if so, apply it.

R410.17 In the case of a joint audit where the circumstances addressed by paragraph R410.16 apply to only one of the firms expressing the audit opinion, the involvement of the other firm in the joint audit may be regarded as an action equivalent to that in paragraph R410.16.

R410.18 Subject to paragraph R410.19, if the circumstances described in paragraph R410.16 continue for five consecutive years, the firm shall cease to be the auditor after the audit opinion for the fifth year is issued.

R410.19 As an exception to paragraph R410.18, the firm may continue to be the auditor after five consecutive years if there are compelling reasons to do so having regard to the public interest, provided that:

- (a) The firm consults with the relevant professional body and it concurs that having the firm continue as the auditor would be in the public interest; and
- (b) After the audit opinion on the fifth and any subsequent year's financial statements has been issued, the firm engages a professional accountant who is not a member of the firm expressing the opinion on the financial statements to perform an engagement quality review of that engagement; or a professional body to perform a review of that engagement that is equivalent to an engagement quality review.

410.19 A1 A factor which might give rise to compelling reasons is the lack of viable alternative firms to carry out the audit engagement, having regard to the nature and location of the client's business.

Total Fees – Overdue Fees

410.20 A1 A self-interest threat might be created if a significant part of fees is not paid before the audit report for the following year is issued. It is generally expected that the firm will require payment of such fees before such audit report is issued. The requirements and application material set out in Section 511 with respect to loans and guarantees might also apply to situations where such unpaid fees exist.

410.20 A2 Factors that are relevant in evaluating the level of such a self-interest threat include:

- The significance of the overdue fee to the firm.
- The firm's assessment of the ability and willingness of the client to settle the overdue fee.

410.20 A3 Examples of actions that might be safeguards to address such a self-interest threat include:

- Obtaining partial payment of overdue fees.
- Having an appropriate reviewer who did not take part in the audit engagement review the audit work performed.

R410.21 When a significant part of fees due from an audit client remains unpaid for a long time, the firm shall determine:

- (a) Whether the overdue fees might be equivalent to a loan to the client; and
- (b) Whether it is appropriate for the firm to be re-appointed or continue the audit engagement.

Transparency of Information Regarding Fees for Audit Clients that are Public Interest Entities

410.22 A1 As noted in paragraph 410.2, the level of threats to independence, particularly independence in appearance, is generally greater for public interest entities. In this regard, the nature and level of fees might affect the perceptions of those charged with governance, investors and other stakeholders. As transparency can serve to better inform the views and decisions of these stakeholders, this section provides for disclosure of fee-related information to both those charged with governance and stakeholders more generally for audit clients that are public interest entities.

Communication About Fee-related Information with Those Charged with Governance

Audit Fees

- R410.23** The firm shall communicate in a timely manner with those charged with governance of an audit client that is a public interest entity regarding:
- (a) The amount of the fee for the audit of the financial statements, and the factors or other relevant information that the firm took into account in determining it;
 - (b) Any fees for the audit of special purpose financial statements and review engagements; and
 - (c) How the firm complied with paragraph R410.4.
- 410.23 A1 Clear communication with those charged with governance about the level of the audit fee and how it was determined provides factual information that assists them in assessing the firm's independence in fulfillment of their responsibilities. Effective communication in this regard also allows for a two-way open exchange of views and information about, for example, the expectations that those charged with governance might have regarding the scope and extent of audit work and impact on the audit fee.
- 410.23 A2 Examples of relevant audit fee information that the firm might discuss with those charged with governance include:
- Considerations affecting the level of the fee such as:
 - The scale, complexity and geographic spread of the audit client's operations.
 - The need to utilize specialist resources.
 - The quality of record keeping and processes for financial statements preparation.
 - Any adjustments to the fee quoted or charged during the course of the audit, and the reasons for any such adjustments.
 - Any changes to laws and regulations and professional standards relevant to the audit that impacted the fees.
- 410.23 A3 The firm is encouraged to provide such information as soon as practicable, preferably as part of the planning stage of the audit, with any proposed adjustments communicated as they are determined.

Fees for Services Other than Audit

- R410.24** The firm shall communicate in a timely manner with those charged with governance of an audit client that is a public interest entity regarding the fees charged during the period covered by the financial statements for the provision by the firm or a network firm of services other than audit to the audit client (which for this purpose shall include only related entities over which the audit client has direct or indirect control).
- 410.24 A1 Examples of information about fees that the firm might discuss with those charged with governance include:
- The amount of fees from services other than audit that are required by laws and regulations.
 - The nature of other services provided and their associated fees.
 - Information on the nature of the services provided under a general policy approved by those charged with governance and associated fees.
 - The proportion of fees for services other than audit to the audit fee.
- R410.25** If the firm determines that there is a self-interest or intimidation threat to independence created by the proportion of the fees charged for the provision by the firm or a network firm of services other

than audit relative to the audit fee, the firm shall communicate with those charged with governance of an audit client that is a public interest entity regarding:

- (a) Whether the threats created by the provision of such services are at an acceptable level; and
- (b) The safeguards that the firm has taken or intends to take to reduce such threats to an acceptable level.

Fee Dependency

R410.26 Where the total fees from an audit client that is a public interest entity and its related entities represent or are likely to represent more than 15% of the total fees received by the firm, the firm shall communicate with those charged with governance regarding:

- (a) That fact and whether this situation is likely to continue;
- (b) The safeguards applied to address the threats created, including, where relevant, the use of a pre-issuance review (Ref: Para R410.16); and
- (c) Any proposal to continue as the auditor under paragraph R410.19.

Public Disclosure of Fee-related Information

R410.27 The firm shall be satisfied that the following information is publicly disclosed in a timely manner, providing appropriate accessibility:

- (a) The amount of the fee for the audit of the financial statements;
- (b) The amount of fees charged during the period covered by the financial statements for the provision by the firm or a network firm of services to the audit client (which, for this purpose shall include only related entities over which the audit client has direct or indirect control) other than as disclosed under (a); and
- (c) If applicable, the fact that the total fees received by the firm from the audit client and its related entities represent, or are likely to represent, more than 15% of the total fees received by the firm for two consecutive years, and the year that this situation first arose.

The requirements in subparagraphs (a) to (c) above shall be met by compliance with laws and regulations which substantively satisfy the corresponding requirements.

410.27 A1 The fees disclosed usually reflect the fees paid or estimated to be paid for the services based on the information available at the time of the disclosure. The fees paid or estimated to be paid for the audit engagement include all such fees paid or payable to firms in relation to the audit work performed on which the audit opinion is based. In the case of a group audit, this would include the work carried out by any component auditor at the direction of the group engagement partner as set out in ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

410.27 A2 Examples of compliance with laws and regulations which would not substantively satisfy paragraph R410.27 include:

- Excluding, in the case of a group audit, fees charged by any component auditors carrying out work at the direction of the group engagement partner.
- Excluding fees for services other than audit provided by network firms to the audit client and related entities over which the client has direct or indirect control.

410.27 A3 In some circumstances, the audit client might agree to disclose such information, for example in its financial statements or annual report, including any specific public report of those charged with

governance on their assessment of the firm's independence. Otherwise, the firm might consider other suitable locations, such as the proxy statement or the audit report for such disclosure.

410.27 A4 If the firm discloses the information required by paragraph R410.27 in the audit report, *[Placeholder on appropriate reference will be added subject to agreement with IAASB on suitable reference to where in the audit report firms should make the disclosure].*

410.27 A5 The firm might also discuss with the client if disclosure of other information relating to fees might enhance the reader's understanding. Examples of such information include:

- Comparative information for the prior year's fees for audit and services other than audit.
- Nature of services provided other than audit and their associated fees.
- Safeguards applied when the total fees from the client represent or are likely to represent 15% of the total fees received by the firm.

410.27 A6 The disclosure is regarded as appropriately accessible if the information required by paragraph R410.27 is readily available for any stakeholder in a manner that stakeholders are specifically informed about or the firm has reason to believe that stakeholders know about.

Considerations for Review Clients

R410.28 This section sets out requirements for firms to communicate fee-related information of an audit client that is a public interest entity and be satisfied that such information is publicly disclosed. As an exception to those requirements, in the circumstance where a review client is not also an audit client, the firm may determine not to communicate or pursue disclosure of such information. (Ref: Para R410.23-R410.27)