

Meeting: IESBA CAG
Meeting Location: New York
Meeting Date: March 9, 2020

Agenda Item H-2

Report Back – Fees

Objectives of Agenda Item

1. To note the report-back on the September 2019 CAG discussion.
2. To encourage CAG member organizations to respond to the Exposure Draft (ED), [Proposed Revisions to the Fee-related Provisions of the Code](#).

Project Status and Timeline

3. In its [Strategy and Work Plan, 2019-2023](#) the IESBA committed to undertaking work to further understand a number of fee-related matters raised by the regulatory community. In addition, the IESBA committed to responding to the Public Interest Oversight Board who had asked the IESBA to revisit issues on auditor independence and “non-audit services” more broadly, including fee-related matters.
4. In September 2018, pursuant to the June 2018 final report of the Fees Working Group ([Fees Final Report](#)), the IESBA approved the project proposal. The objective of the project is to review the fee-related provisions in the [International Code of Ethics for Professional Accountants \(including the International Independence Standards\)](#) (the “Code”) pertaining to fee-related matters.
5. Appendix 1 to this paper provides a history of previous discussions with the CAG on this topic.

Fees ED

6. The IESBA approved the [Fees ED](#) which sets out proposed revisions to fee-related provisions in December 2019. The ED was released in January 2020 and is open for comment through **May 4, 2020**. **CAG Member Organizations are strongly encouraged to submit a comment letter to the IESBA by the comment deadline.**
7. A summary of the responses to the ED will be presented to the CAG at its September 2020 meeting. The IESBA anticipates finalizing the Fees project by December 2020.

Fees Webinar

8. To promote awareness of the Fees ED and to encourage feedback from all stakeholders the IESBA will host a free global webinar on March 19, 2020 from 10 am to 11 am (EDT). During the webinar, the Fees Task Force Chair, Mr. Ian McPhee will present the key proposed changes to the fee-related provisions of the Code to the participants. **Representatives of CAG Member Organizations are encouraged to [register](#) to join this webinar and invite others within their network to register as well.**

9. The ED includes an Explanatory Memorandum (EM) with questions for respondents and summarizes the IESBA’s rationale for its proposals. The ED forms part of the CAG reference materials.

September 2019 CAG Discussion

10. Below are extracts from the draft minutes of the September 2019 CAG meeting¹ and an indication of how the Task Force/IESBA has responded to CAG Representatives’ comments.

Matters Raised	Task Force/ IESBA Response
LEVEL OF AUDIT FEES	
<p>Mr. Thompson noted that as the audit evolves, fees can change and there might be fees charged after the signing of the auditor’s report. He asked whether the Task Force considered that case.</p> <p>Messrs. Yurdakul, Thompson and Bradbury expressed concerns about the proposed timing for the assessment and suggested that the Task Force reconsider its proposal. They suggested that the assessment about whether fees are appropriate should take place before the firm starts the audit engagement.</p>	<p>Points accepted.</p> <p>Mr. McPhee explained that the Task Force considered the fact that audit fees may be charged after a firm signs its auditor’s report but opted to put forward a proposal which avoided undue complexity.</p> <p>After the meeting, the Task Force reconsidered and withdrew its initial proposal that would require firms to 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 the firm’s ability to perform the audit in compliance with the fundamental principles.</p> <p>The IESBA agreed to approach the issue by focusing on the overall threats to independence created by fees paid by the audit client and by the level of fees. See paragraphs from R410.4 to 410.5 A3 in the Fees ED which includes a proposal that requires the firm to determine whether the threats to independence created by the fees proposed to the client are at an acceptable level.</p>
<p>Mr. Dalkin supported the Task Force’s proposal, including the proposed timing for assessing the sufficiency of resources (instead of fees charged) to perform the audit. He suggested that the Task Force move away from focusing on audit fees charged.</p>	<p>Point accepted.</p> <p>Mr. McPhee responded that the proposal being considered by the IAASB related to resources in a broad sense, while the Code is intended to emphasize the independence issue which arises because of the fees charged.</p> <p>Also, please refer to the response above.</p>

¹ The September 2019 CAG minutes will be approved during the March 2020 IESBA CAG meeting.

Matters Raised	Task Force/ IESBA Response
<p>Mr. Hansen wondered whether a possible unintended consequence of the proposed requirement might be that the auditor may identify a matter that he/she is not comfortable with and instead of dealing with it, may instead use the proposed requirement as a way to avoid forming a conclusion on the matter. He questioned whether the Task Force considered that scenario.</p> <p>Reflecting on that comment, Mr. Dalkin added that in his view, a firm may misuse or abuse the proposed requirement to negotiate higher than appropriate audit fees for an audit engagement.</p>	<p>Points accepted.</p> <p>Mr. McPhee responded that the Task Force's intention was to shift away from establishing a level of fees that firms should charge for an audit engagement. The Task Force's proposal is principles-based and it is proposing provisions that will encourage discussions between the audit firm and the audit client about the implications of fees charged for the audit.</p> <p>Also please see response above regarding the withdrawal of the proposal.</p>
<p>Mr. Yurdakul questioned who should judge whether the level of fees is appropriate. He noted that the Task Force should reconsider the wording of "to be satisfied" in the requirement, because it is too subjective.</p>	
<p>Mr. Bradbury supported the Task Force's proposal regarding the need to consider how a firm might be influenced by the fees charged for providing services other than the audit. He noted that in some situations, the NAS is more lucrative and that it becomes hard for an entity to identify a firm that is willing to undertake the audit engagement. He noted that in his view, it is not necessarily the availability of a NAS engagement that contributes to "low-balling" and that in some cases a firm may charge a lower audit fee to secure a prestigious client, or to enter a new market.</p>	<p>Support noted.</p>
<p>PROPORTION OF FEES</p>	
<p>Mr. Thompson pointed out that in some jurisdictions (e.g. in the European Union (EU)) audit fee covers only the audit of the financial statements, and that the fees for review engagements form part of non-audit fees. He observed that the term "fees" in the Task Force proposals is intended to cover audit as well as review engagements and suggested that the Task Force consider clarifying what the intended</p>	<p>Points taken into account.</p> <p>Regarding the proportion of fees, the proposed revisions to the Code do not include a requirement with any restriction or exact threshold. Therefore, the Task Force was of the view that the proposed application material is unlikely to conflict with any laws and regulations which sets out specific threshold for the proportion of fees for the audit of the financial statements to other fees.</p>

Matters Raised	Task Force/ IESBA Response
<p>meaning of the term “audit fees” in its proposal. He also suggested that the Task Force consider aligning its proposals with the EU regulations .</p> <p>Mr. Hansen and Mr. Hirai supported that point and agreed with the suggestion.</p> <p>Mr. Cela expressed support for the Task Force’s proposals and added that in his view the focus should be on the proportion of fees for audit of financial statements to other fees.</p>	<p>Also, the application material in paragraph 410.10 A1 is in line with the drafting guidelines of the Code in that the independence provisions in Part 4A are applicable to audit and review engagements.²</p> <p>Paragraphs 410.10 A1 to 410.10 A3 of the Fees ED include the new proposed wording of the application material regarding proportion of fees.</p>
<p>Mr. Cela supported the Task Force’s position that a high proportion of fees for the audit to other fees creates threats to independence. He supported the need for including a threshold in the Code, noting that without having a specific threshold to guide firms, the evaluation of such threats would be too subjective.</p>	<p>Point taken into account.</p> <p>Mr. McPhee explained that the challenge with setting the threshold is that the nature of the specific types of service affects the level of the threat that is created. Accordingly, the Task Force is cautious about establishing a generic threshold. Mr. McPhee noted that the Task Force has heard a number of arguments for and against having a threshold in the Code and will aim to find a reasonable and balance solution in finalizing its proposals.</p> <p>The IESBA agreed not including an exact threshold or other restriction to the proportion of fees. As the proportion of fees would be determinable also at a network level, the calculation of the exact ratio of fees for services other than audit to the audit fee may involve some complexities, and firms might not be able to obtain all the necessary information in a timely manner. On balance, the IESBA is of the view that the Code should take a principles-based approach and provide the flexibility for firms to evaluate the threats created by the proportion of fees for other services delivered throughout the period during which independence is required.</p>
<p>FEE-DEPENDENCY</p>	
<p>Mr. Hansen shared statics about the total revenue generated by the top 25 firms from one of their audit clients and asked whether the Task Force is aware of the fact that the proposals regarding fee-</p>	<p>Point taken into account.</p> <p>Mr. McPhee responded that the Task Force believes that its proposals are proportionate and that the suggested 5-year period that form part of the proposal for non-PIE audit clients could be</p>

² Paragraph 400.1 of the Code

Matters Raised	Task Force/ IESBA Response
<p>dependency might have relevance only for small- and medium-sized firms.</p>	<p>expected to provide sufficient time for those firms to take necessary steps to deal with the fee dependency issue.</p> <p>In the EM the IESBA explicitly seeks stakeholder’s views regarding the appropriateness of the proposed thresholds for non-PIE audit clients (see question 6 in the EM).</p>
<p>Ms. McGeachy acknowledged the changes that the Task Force made to address the SMPC comments and asked for clarification regarding some of them.</p>	<p>Acknowledgement noted.</p>
<p>Ms. McGeachy suggested that the Task Force expand the requirement to include independent regulatory bodies because the professional body may not be the licensing body and may in some cases decline the request.</p> <p>Mr. Hirai added that consultation with the professional body on the continuation of the audit may create a conflict of interest.</p>	<p>Point accepted.</p> <p>Mr. McPhee acknowledged that seeking the concurrence of the professional body may be seen as a conflict of interest. However the Task Force believed the professional body to be a legitimate third party that has a broad view of the market in which the firm operates. He noted that the Task Force will consider including the independent regulatory body, adding that the Task Force has been cautious about having provisions that result in “forum shopping”.</p> <p>The IESBA agreed to include both the independent regulatory body and the professional body as bodies from which firms could receive concurrence to continue the audit engagement (see paragraph R410.20 (a) in the Fees ED).</p>
<p>Ms. McGeachy proposed including a reference to “local market and practice conditions” as a matter for consideration in determining the applicability of the exception because in her view the local market and practice conditions are relevant to the evaluation of the public interest need to continue the engagement.</p>	<p>Point taken into account.</p> <p>Mr. McPhee explained that the Task Force is not aiming to provide too much flexibility with the exception, but would consider the suggestion.</p> <p>The IESBA agreed to include reference to the “lack of viable alternative firms to carry out the audit engagement, having regard to the nature and location of the client’s business” as a suitable example of a compelling reasons to continue the engagement (see paragraph 410.20 A1 in the Fees ED).</p>

Matters Raised	Task Force/ IESBA Response
<p>Ms. Robert pointed out that in the EU, there is legislation with respect to fee-dependency in case of PIE audit clients. In relation to that, she made the following comments:</p> <ul style="list-style-type: none"> ○ The requirement that applies in the EU is for firms to communicate the threats created by the fee-dependency and the safeguards applied with TCWG. She asked whether the Task Force plans to have similar proposals, including matters regarding fee-dependency. ○ Under the requirement that applies in the EU firms must take specific actions in case of fee-dependency after 3 consecutive years. She pointed to the difference in the proposed number of years in the Task Force’s proposals and suggested that the Task Force consider aligning with the approach already in practice in the EU. ○ Ms. Robert referred to jurisdictions in the EU where some firms are not allowed to end the audit engagement after 5 years and asked whether the “compelling reasons” in the Task Force proposals are intended to cover that situation. 	<p>Points taken into account.</p> <p>Mr. McPhee clarified that the Task Force’s proposals includes provisions that require firm of audit clients that are PIEs to communicate with TCWG about fee-related matters (see paragraphs R410. 24 of the Fees ED).</p> <p>The extant Code require firms to take certain actions in the case of fee-dependency after 2 consecutive years. The Task Force considered whether to propose changes, but found no evidence from the fees fact-finding to support changing the extant threshold from 2 to 3 years.</p> <p>Paragraph R410.20 of the Fees ED sets out that firms may continue to be the auditor after five consecutive years if there is a compelling reason to do so having regard to the public interest. This compelling reason is not intended to cover the case when a national law or regulation does not allow the auditor to end the engagement as the Code already addresses such a circumstance in the overarching requirement in Section 100³ to the effect that the Code cannot override laws or regulations. Therefore, if laws or regulations prohibit a firm from ending the audit engagement after five years, the firm must continue to be the auditor for such period as required under those laws or regulations.</p>
<p>ENHANCED TRANSPARENCY OF FEE-RELATED INFORMATION OF PIE AUDIT CLIENTS</p>	
<p>Mr. Hirai noted that in his experience, audit clients do not usually have information about fee-dependency and that it does not seem practical for this disclosure to be made by the audit client in the financial statements and the annual report.</p>	<p>Point taken into account.</p> <p>Mr. McPhee responded that the Task Force is of the view that the firm can provide this information to their clients. He added that the Task Force does not anticipate many cases of fee-dependency. It is expected that disclosures about the level of fees and fee ratios would be more common.</p>

³ Paragraph R100.3 sets out the following: “A professional accountant shall comply with the Code. There might be circumstances where laws or regulations preclude an accountant from complying with certain parts of the Code. In such circumstances, those laws and regulations prevail, and the accountant shall comply with all other parts of the Code.”

Matters Raised	Task Force/ IESBA Response
<p>Ms. Meng noted that for investors, with regard to the timing, it is better to have information from the audit client.</p>	<p>Point taken into account.</p> <p>Mr. McPhee indicated that this is consistent with the Task Force’s view and that the Task Force is conscious that audit clients might be reluctant to disclose this information.</p> <p>Paragraph 410.25 A3 of the Fees ED sets out that the fee-related information of the PIE audit client might be disclosed,</p> <p>(a) By the audit client in its financial statements, annual report or proxy statement, or</p> <p>(b) If not by the audit client, by the firm in a manner deemed appropriate for the circumstances.</p>
<p>Ms. Meng wondered whether it is appropriate to require that firms disclose only a factual statement about fee-dependency. She questioned the Task Force’s rationale for not requiring more, for example, the exact ratio.</p>	<p>Point not accepted.</p> <p>Mr. McPhee indicated that the Task Force discussed this issue and agreed that it is not necessary to go that far. He noted that firms might end up disclosing this information.</p> <p>The IESBA also recognized that firms may not be able to determine an exact ratio regarding fee dependency. Accordingly, the proposals in paragraphs R410.24 and R410.25 (c) of the Fees ED require the disclosure of the fact that the 15 percent threshold is exceeded, and does not require the firm to disclose the exact ratio.</p>
<p>Mr. Dalkin suggested that the Task Force consider including the “peer review report” as an example of a suitable location for disclosure, since in the US the peer review report is publicly available.</p>	<p>Point taken into account.</p> <p>The Fees ED includes examples of suitable locations for disclosure of fee-related information that would be applicable in a global context in paragraph 410.25 A3 (for example, in its financial statements, annual report or proxy statement). The example of the “peer review report” is deemed to be germane to the US.</p>
OTHER MATTERS	
<p>Ms. McGeachy questioned whether a joint audit could be regarded as equivalent to the pre-issuance review in each year, regardless of the period.</p>	<p>Point accepted.</p> <p>Mr. McPhee clarified that a joint audit, if certain criteria are met, could be applied as a safeguard each year when pre-issuance review is required.</p>

Matters Raised	Task Force/ IESBA Response
<p>In relation to the safeguards in case of non-PIEs, Mr. Hirai asked why they are different from the safeguards for audit clients that are PIEs.</p>	<p>Point taken into account. Ms. Sramko clarified that the Task Force aimed to provide more flexibility for non-PIEs regarding the review performed as a safeguard based on comments from SMPC.</p>
<p>Mr. Dalkin noted that in his view, it would be difficult or impossible to impose some of the fee-related requirements on US firms as a result of the legal and regulatory environment. He suggested that the Task Force to explore the legal implications of the US anti-trust laws.</p>	<p>Point taken into account. After the meeting the Task Force liaised with representatives of the American Institute of Certified Public Accountants (AICPA) and the National Association of State Boards of Accountancy (NASBA) to consider the possible legal implications of its proposals in the US. The issue is also discussed in the EM to the Fees ED and a question is included to solicit views about the operability of the proposals in the Fees ED in the national context.</p>

Matter for Consideration

- Representatives are asked to note the report back.

Material Presented – FOR IESBA CAG REFERENCE PURPOSES ONLY

ED, [Proposed Revisions to the Fee-related Provisions of the Code](https://www.ethicsboard.org/publications/proposed-revisions-fee-related-provisions-code)

Project History

Project: Fees

Summary

	CAG Meeting	IESBA Meeting
Information gathering/ Discussion	March 2018	March 2018
Project commencement, including: <ul style="list-style-type: none"> • Consideration of information from fact-finding activities • Approval of project proposal 	September 2018	June 2018 September 2018
Development of proposed international pronouncement (up to exposure)	March 2019 September 2019 March 2020	March 2019 June 2019 September 2019 December 2019