

**Meeting:** IESBA CAG

**Meeting Location:** New York

**Meeting Date:** September 10, 2018

## Agenda Item

# B

### Fees

#### Objective of Agenda Item

1. To report back on the discussions at the March 2018 CAG meeting.
2. To obtain Representatives' views on the Working Group's (WG) final report on its fact finding activities, including the recommended way forward, and on the Fees Project Proposal.

#### Project Status and Timeline

##### Establishing a Working Group and Terms of Reference

3. The IESBA's Strategy and Work Plan 2014-2018 includes a commitment for the IESBA to explore fee-related matters raised by the regulatory community and determine whether there is a need for further enhancements to the Code or the commissioning of staff guidance.
4. In approving due process for certain changes to the independence provisions of the Code pertaining to non-assurance services (NAS) at its March 2015 meeting, the PIOB called on the IESBA to revisit issues on auditor independence and NAS from a broader perspective, including consideration of fee-related issues. In response to this call and in the context of its strategic commitment to explore fee-related matters, the IESBA established the WG.
5. As an initial step to further work in this area, the IESBA commissioned its staff to develop a publication to highlight important considerations that already exist in the Code for auditors in relation to the setting of audit fees. The IESBA Staff publication, [\*Ethical Considerations Relating to Audit Fee Setting in the Context of Downward Fee Pressure\*](#), was released in January 2016.
6. At its March 2016 meeting, the IESBA:
  - (a) Approved the WG's Terms of Reference; and
  - (b) Agreed the scope and focus of, and approach to, the WG's fact finding work.
7. The WG's objective, under its [\*Terms of Reference\*](#), was to undertake fact finding in the following areas with a view to identifying whether there is a relationship between fees and threats to compliance with the fundamental principles or to independence, or whether there are reasonable perceptions that such threats exist, as well as how such threats might be addressed:
  - (a) Level of audit fees for individual audit engagements.
  - (b) Relative size of fees to the partner, office or the firm, and the extent to which partners' remuneration is dependent upon fees from a particular client (fee dependency).
  - (c) The ratio of non-audit services fees to audit fees paid by an audit client.

- (d) The provision of audit services by a firm that also has a significant non-audit services business (business model).

### **Fact Finding Activities and Fees WG Final Report**

8. The WG's fact finding activities included:
  - (a) A high level review of the relevant fee provisions in a number of G-20 jurisdictions (G-20 benchmarking);
  - (b) A review of relevant academic research and other literature; and
  - (c) Outreach to stakeholders to obtain their perspectives about the fee-related matters (stakeholder outreach).
9. Subsequently, the IESBA commissioned an academic, Prof. David Hay, to undertake a review of relevant academic and other literature for purposes of informing the IESBA's future actions on the topic. Prof. Hay presented his [report](#) at the December 2016 IESBA meeting and then at the IESBA CAG meeting in March 2017. In December 2016 the IESBA also received an update from the WG on the review of relevant laws and regulations in G20 jurisdictions as they relate to fees.
10. As the third key fact finding element of this initiative, the IESBA released a [Fees Questionnaire](#) to gather further views from stakeholders with respect to certain fee-related matters in November 2017. The comment deadline for the Fees Questionnaire was March 1, 2018 and [73 respondents](#) commented, representing a diverse group of stakeholders from many jurisdictions.
11. In March 2018, the CAG received a presentation highlighting preliminary themes based on a staff review of responses to the Fees Questionnaire. The CAG was also given an opportunity to express views on the presentation and the matters in the Fees Questionnaire, in particular, in relation to:
  - (a) Independence considerations relating to the ratio of non-audit services fees to audit fees paid by an audit client; and
  - (b) Ethical and independence implications of a firm's provision of audit services when it also has a significant non-audit services business.
12. At the June 2018 IESBA meeting, the WG presented its [final report](#) (see reference material) on the outcome of the fact finding activities. The final report included the WG's recommended way forward with respect to the four focus areas in paragraph 7. It also incorporated input from the CAG based on previous CAG discussions on relevant fee-related matters.
13. The final report also acknowledged suggestions from the International Organizations of Securities Commissions (IOSCO) about how the examples of fee-related safeguards in the extant Code should be improved. The WG noted that similar suggestions were considered by the IESBA in finalizing its Safeguards project, but plans to revisit as part of the project.
14. The IESBA generally supported the WG's recommended way forward and agreed to consider a project proposal at its September 2018 meeting.

### **Upcoming IESBA Meeting**

15. The project proposal to be considered by IESBA at its September 2018 meeting is set out in **Agenda Item B-1**. The project proposal summarizes plans to consider a fees project that will involve among other matters:

- (a) Strengthening the fees provisions in the Code based on:
- A review of the provisions in Part 3<sup>1</sup> of the Code with respect to the level of audit fees for individual audit engagements;
  - A review of the provisions in International Independence Standards, in particular Part 4A<sup>2</sup> of the Code with respect to fee dependency at a firm, office and partner level for all public interest entity (PIE) audit clients, including considering a specific threshold for non-PIE audit clients; and
  - A review of the fee-related safeguards in the Code pertaining to the scope of the project.
- (b) Updating the January 2016 [Fees Staff Publication](#) to align it with the revisions to the Code, in light of the finalization of the Structure of the Code and Safeguards projects.
16. The WG notes that certain issues may require input from other IESBA Working Groups and the International Auditing and Assurance Standards Board (IAASB). For example, as noted in **Agenda Item C**, the IESBA will also consider a Non-Assurance Services (NAS) project proposal to review the NAS provisions in the Code which will include, among other matters, a consideration of provisions that would require firms to re-evaluate threats to independence when the ratio of NAS fees to audit fees reach a particular threshold.
17. The proposed Fees project will not deal with issues and questions that have been raised about whether the IESBA has a role to play in responding to broader concerns about audit quality and auditor independence that might arise from the multi-disciplinary consulting and advisory services provided by firms and network firms (i.e., firms' business model). Those matters have been referred to the IESBA Planning Committee for further consideration.

#### Report Back on March 2018 CAG Discussions

18. Below are extracts from the draft minutes of the March 2018 CAG meeting<sup>3</sup> and an indication of how the WG/IESBA has responded to CAG Representatives' comments.

Matters Raised	WG/ IESBA Response
MATTERS RELATING TO NAS, INCLUDING FEE CAPS	
Mr. Koltvedgaard explained that the ratio of NAS to audit fees had been highlighted as a potential matter for further consideration in Prof. Hay's review of academic literature.  Mr. Thompson noted that the levels of NAS to audit clients and non-audit clients are very different issues, noting that in relation to the	Points taken into account and factored into the development of the Fees and NAS project proposals.  During the meeting: <ul style="list-style-type: none"><li>• Mr. McPhee explained that the Working Group was still in the fact finding stage and</li></ul>

<sup>1</sup> Part 3 – Professional Accountants in Public Practice, Section 310, *Fees* and Section 330, *Fees and Other Types of Remuneration*

<sup>2</sup> International Independence Standards, Part 4A – Independence for Audit and Review Engagements, Section 410, *Fees* and Part 4B – Independence for Assurance Engagements Other Than Audit and Review Engagements, Section 950, *Fees*

<sup>3</sup> The March 2018 CAG minutes will be approved during the September 2018 IESBA CAG meeting.

<p>former, the EU has introduced a 70% cap and it is still too early to know how that is working out in practice. He noted that there are many academic studies on the topic of fees and most are inconclusive. However, he acknowledged that there is a big perception issue amongst stakeholders. His personal view was that NAS should not be provided to audit clients.</p> <p>Mr. Van der Ende acknowledged the difficulty of identifying hard evidence. Nevertheless, he had expected at least some suggestions for a proposed way forward. He remarked that he would have expected that even if not some hard evidence, at least some signals would have come from the fact finding activities by now. In this regard, he shared that some Basel Committee constituents had become aware of concerns among some regulators about the adequacy of audit work in some instances, which prompted regulatory inspections. As a result, audit hours and fees went up, which, although not hard evidence in itself, provides a significant indication that auditors had sometimes agreed a relatively low level of fees. He added that he was unsure what the comparison between NAS and audit fees would achieve.</p> <p>Ms. Pettersson shared Mr. Van der Ende's concern about the lack of clear signals as to how the issues will be addressed.</p> <p>Dr. Lawal noted that he had not seen the questionnaire, so he could only share his personal views. He outlined that the ratio of NAS to audit fees depends on a number of factors, such as the nature of industry, maturity of the market, the expertise of the firm in particular industries, the structure of the market, etc. Therefore, it would be difficult for the IESBA to set fixed thresholds in the Code.</p> <p>Dr. Manabat thought that this issue should be approached in a different way. She believed that when discussing audit fees, one has to consider independence and quality. In the context of a global audit and global fees, she wondered how the pie could be shared, as countries differ on their levels</p>	<p>that it would be meeting in April to consider the information gathered and develop its final report to present to the IESBA in June 2018.</p> <ul style="list-style-type: none"> <li>Mr. Fleck shared that in the UK, the issue of what should be the right level of audit fee has been considered for many years, but that it remained an insolvable problem due to anti-competition laws. Hence, the principles-based approach taken has been to emphasize performing a high quality audit irrespective of the fee charged. He also noted that in the UK, audit committees at large companies often reject the lowest fees on a tender, although smaller companies tend to be more sensitive to the level of fees quoted. He believed that this went back to the issue of governance. He also noted that the EU was facing the same difficulty when setting out the EU Regulation.</li> </ul> <p>Subsequent to the March CAG meeting discussion, and based on the outcome of the June 2018 IESBA meeting, the WG has referred all NAS-related comments to the NAS Working Group. The WG notes that the NAS Working Group:</p> <ul style="list-style-type: none"> <li>Is recommending that the IESBA consider and approve a project that would involve a full review of the NAS provisions in the Code.</li> <li>Received cautionary comments about the suggestion to include fee-caps in the Code from some participants at the global roundtables in Washington DC, Paris, Tokyo and Melbourne in June and July 2018.</li> <li>Is planning to consider issues referred by the Fees working group, including whether the Code should include provisions that would require firms to re-evaluate threats to independence when the ratio of NAS fees to audit fees reach a particular threshold.</li> </ul>
---	--

<p>of maturity. Since multinational companies operate all over the world, she queried whether the practice is the same everywhere. She also questioned whether outsourcing audit work would impact audit quality and independence.</p> <p>Mr. Thompson expressed his view that there is a perception of an issue among stakeholders related to the ratio of NAS to audit fees, and therefore this perception should be addressed. He also added that it is difficult for the IESBA to address fee-related issues, since fees are subject to business decision and market forces.</p>	
LEVEL OF FEES	
<p>Mr. James indicated that it was a challenge for IOSCO Committee 1 to answer the questions in the survey questionnaire because they were so subjective. So, instead, it considered areas relating to fees where the Code potentially could be strengthened. He noted that the concept of low fees is not necessarily wrong; rather, the question is whether it compromises audit quality. He was of the view that auditors should make the basis of the audit fee clear to the audit client. He also highlighted Committee 1's view that if there is a breach of an independence requirement, it should be someone within the firm other than a member of the audit team who should address it.</p> <p>Mr. James remarked that some of the safeguards in the Code are not necessarily safeguards but what auditors should do and should be expected to do. He also felt that the cumulative effect of services the firm is providing to an audit client should be considered when looking at the impact on compliance with the fundamental principles and independence, not just the effect of the individual service.</p> <p>Mr. Iluma shared the perspectives of Mr. James. He reported that in Japan the audit industry is very competitive, and companies are demanding the firms to lower audit fees every year. He expressed his hope that the provisions of the Code would help address the issue of downward pressure on audit fees.</p>	<p>Points related to level of fees charged are accepted and taken into account in the development of the Fees project proposal.</p> <p>In relation to the suggestions about safeguards, the WG noted that similar suggestions were considered by the IESBA in finalizing its Safeguards project. Notwithstanding this, the WG plans to revisit fee-related safeguards as part of the Fees project.</p> <p>See the proposed scope and timing of that project in the Fees project proposal in <b>Agenda Item B-1</b>.</p>

<p>Mr. Dalkin noted that setting out fixed thresholds in the Code would be a move away from principles-based standards. He acknowledged that it is hard for standard setters to prescribe levels of fees without being considered as regulators.</p> <p>Ms. McGeachy-Colby acknowledged the perception issue. She noted the global survey undertaken by the IFAC SMP Committee, which received over 5000 responses. The responses highlighted downward pressure on audit fees as a significant concern. She expressed the view that there is now a good opportunity for the IAASB and IESBA to collaborate and undertake awareness raising to highlight the robust standards that are already in place related to fees, and to emphasize that fees need to be sufficient for audit quality.</p>	
MATTERS RELATING TO AUDIT QUALITY, INCLUDING BUSINESS MODEL ISSUES	
<p>Ms. Pettersson informed the CAG that the PIOB is very concerned about the issues of fees. She indicated that the PIOB's view is that there is a direct relationship between fees and audit quality, since fees affect resource allocation. She also noted the PIOB's observation about the growing trend in consulting fees vs. audit revenues, which is not an accident but a result of firms' business strategy. Ms. Pettersson added that some within the PIOB believe there is a need to discuss the business model issue, as well as how services are being charged.</p>	<p>Points noted.</p> <p>The WG notes that the points about business model, audit quality and challenges in developing countries extend beyond the remit of the Fees initiative. The topic of business model has been referred to the IESBA Planning Committee for further consideration (see also discussion in the Appendix to the Fees project proposal in <b>Agenda Item B-1</b>).</p>
<p>Mr. Koltvedgaard queried whether the concern is that a higher level of provision of NAS has a negative impact on audit quality, and whether it is possible to observe a shift in resources in firms from audit to consulting services.</p>	
<p>Mr. Sarmiento Pava expressed his view that the environment in developed and developing countries is not the same. In particular, he noted that corruption issues are worsening in the latter. He also noted that in Colombia, while there are mandatory standards, the rules on securing a new client are not clear and not all professionals follow them. Therefore, he believed that clearer standards are needed, also for the sake of the</p>	

supervision, and that the Code should apply in the whole Latin American region.	
Ms. Borgerth agreed. She reported that in a developing country, it is difficult to obtain quality information to make a judgment on the issues. She noted that it seemed that large audit firms have more stable conditions, but there is less information on fees from smaller firms, hence her difficulty in commenting on the topic	
Ms. Perera reported that in Sri Lanka, the topic of fees has not been discussed. However, what has been observed is that audit quality tends to come down when NAS constitute a large proportion of a firm's business.	
OTHER MATTERS	
Mr. Hansen commented that the survey questionnaire raised issues that should be addressed. He was of the view that fees are important in every audit because they influence the allocation of resources. He informed the participants that in his jurisdiction, he had been involved in a number of disciplinary hearings, especially with respect to small listed audits, where it was inconceivable that a quality audit could be performed for the fees charged. He added that essentially, some firms were selling their signatures for a fee. He also highlighted the issue of "cookie cutter" audits where firms did not really understand what the particular audit needed to achieve. He was of the view that when fees are inconceivably low or high compared to the expected level of work, that should be a concern. Also, he thought that if a firm is prepared to do an audit at a low fee in order to secure contracts for consulting services that should be a concern.	Points noted.
Ms. Singh noted that her organization had difficulties obtaining feedback from its members to the survey questionnaire. She added that she shared the concerns expressed by Mr. Hansen.	
Ms. Elliott was on the view that different industries have different specificities. She reported that the OECD had revamped its guidelines on insurers' governance, and in that context she believed that	

audit committees should have a specific role to play in thinking about these difficult questions.	
---	--

### **Matters for CAG Consideration**

19. At its September 2018 meeting, the CAG will receive a presentation summarizing the [Fees final report](#) and the rationale for the matters included in the project proposal.
20. Representatives will be asked to:
  - (a) Note the report back in paragraph 18.
  - (b) Consider the presentation and share views about the fees final report.
  - (c) Provide input on the fees project proposal in **Agenda Item B-1** in advance of its consideration by the IESBA for approval.

### **Material Presented**

Agenda Item B-1

Fees Project Proposal

### **Material Presented – FOR IESBA CAG REFERENCE PURPOSES ONLY**

[Ref. Material to Agenda Item B- Report of the Fees Working Group](#)