

June 4, 2020

## **IFAC Small and Medium Practices (SMP) Committee Response to the International Ethics Standards Board for Accountants (IESBA) Exposure Draft: *Proposed Revisions to the Fee-related Provisions of the Code***

### **INTRODUCTION**

The SMP Committee (SMPC) is pleased to respond to the IESBA (the Board) on this Exposure Draft (ED). The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small-and medium-sized entities (SMEs). The constituents of the SMPC are small-and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members of the SMP Committee have substantial experience within the accounting profession, especially in dealing with issues pertaining to SMEs, and are drawn from IFAC member bodies representing 22 countries from all regions of the world.

### **GENERAL COMMENTS**

The SMPC has been following the development of this project and that of the Non-Assurance Services (NAS) since their inception and welcomes the close coordination of IESBA with the International Auditing and Assurance Standards Board (IAASB). We also concur that the outcome from the work of the Task Force on the definition of Public Interest Entities (PIEs) and Listed Entities (the PIE Project) will be equally impactful on this ED. Hence, we support this project being accelerated. In light of the significant impact the definition of PIE's will have on this ED (and the NAS ED), it is our view that further work on the NAS and Fees projects should be deferred pending a firmer idea or concept being in place from the outcome of the PIE Project as depending on the definition, it may influence our views on the various issues proposed in the Exposure Drafts.

From our response to the [IESBA Fees Questionnaire](#) in 2017 and other previous Board submissions, we have maintained that the issue of fees is one of perception rather than in fact. Take for example IESBA's view as prescribed in paragraph 58 of the Explanatory Memorandum, "the fee dependency would become so persistent and fundamental that no safeguards would be capable of reducing the threats to an acceptable level". The SMPC is not convinced in this respect, because the IESBA has not shown any specific empirical evidence to support its rationale since the inception of the fees project. In addition, the research commissioned by the IESBA in December 2016 does not indicate a clear association between fee dependency and auditor independence or even on audit quality.

In the SMPC's view, when standard-setters plan to change any standard or rule, they need to ascertain whether an extant standard or rule is not effective in the first place (hence, the need to change). In relation to this proposal, the SMPC believes that the IESBA could have conducted a post-implementation review on the extant code and researched further on the correlation between audit quality and fee dependency



while carrying out a survey on practical implementation in each jurisdiction, rather than asking for feedback in Q13 in this ED.

We continue to urge the Board to consider the impact arising from the frequency of changes to the IESBA Code and consider the deferral of further changes unless they are critical. A persistent challenge of the SMP community based on our past SMP Surveys is keeping up with changes in laws and regulations. The 2018 restructured Code, which was effective as of June 2019, included substantive revisions and a new structure and drafting convention. In addition, the Board should reflect on the significant impact of COVID-19, which is likely to be felt for an extended period of time. SMPs are seeing their own businesses being adversely affected but, being the trusted advisor to many SMEs, their resources are being strained to the point of breaking as they try to assist their clients to go through this period of great distress, the likes of which is unprecedented in modern history.

In pursuing its ambition to ensure appropriate auditor independence (in appearance rather than actual), the IESBA must bear in mind the fact that services from many SMPs are generally of a high quality and there are synergies for the entities in consulting their auditors on some specific issues. Advantages for business entities are often the speed of support and the ability to provide bespoke solutions, usually at a lower cost. It would not be in the public interest for the NAS or fees project to lead to denial of key support and services in the aftermath of the current ongoing crisis. The auditor in the SMP knows the client's individual situation and circumstances well and is therefore best placed to provide tailor-made advice very quickly and efficiently – which is what is (and will be for some time to come) urgently needed at present throughout the world.

### **SPECIFIC COMMENTS**

We have outlined our responses to each question (*in italics*) in the ED below.

1. *Do you agree that a self-interest threat to independence is created and an intimidation threat to independence might be created when fees are negotiated with and paid by an audit client (or an assurance client)?*

The SMPC believes that such practice, although generally recognized and accepted throughout the world, might create a self-interest threat and also, might create an intimidation threat to independence. We also concur with the Board that compliance with professional standards, including ethical requirements is an important factor that acts to mitigate the threat and firms might often conclude that the level of the self-interest threat is thus at an acceptable level.

Client's generally will have mechanisms in place for auditor appointment that will also mitigate any threat to independence. We suggest the IESBA consider whether, provided professional standards and ethical requirements are appropriately complied with, and auditor appointment is subject to internal corporate governance requirements – and in the absence of further factors – the threat should not be expected to exceed an acceptable level. We therefore suggest this is clearly articulated in the Code such that only where there are additional factors impacting the level of threat would an evaluation of the threat be needed (and documented), as otherwise the proposal will lead to an additional documentation requirement in every engagement.



2. *Do you support the requirement in paragraph R410.4 for a firm to determine whether the threats to independence created by the fees proposed to an audit client are at an acceptable level:*
  - (a) *Before the firm accepts an audit or any other engagement for the client; and*
  - (b) *Before a network firm accepts to provide a service to the client?*

Yes, subject to our response to Q1 above, the SMPC is of the view that a firm must be satisfied that threats to independence are at an acceptable level, but we question whether a determination on documentation is needed in every single engagement. With this suggested modification, we agree that this is an appropriate requirement to be included in the Code.

3. *Do you have views or suggestions as to what the IESBA should consider as further factors (or conditions, policies and procedures) relevant to evaluating the level of threats created when fees for an audit or any other engagement are paid by the audit client? In particular, do you support recognizing as an example of relevant conditions, policies and procedures the existence of an independent committee which advises the firm on governance matters that might impact the firm's independence?*

The "checks and balances" from corporate governance structures (e.g. where TCWG have a role in auditor appointment) can be used to evaluate the threat of an audit client payer model.

In some circumstances, there may be instances whereby some of the fees for services are set by local law or regulation (e.g. with a fee scale).

While the SMPC acknowledges that the creation of an independent committee to advise on governance matters that might impact a firm's independence is still at a very nascent stage in many jurisdictions, the Committee is of the view that such a structure is simply not feasible for most SMPs.

4. *Do you support the requirement in paragraph R410.6 that a firm not allow the level of the audit fee to be influenced by the provision by the firm or a network firm of services other than audit to the audit client?*

While the SMPC is supportive of this requirement, it is equally important for clients to be convinced of this message in the first place. We believe this is an area that IESBA's outreach will be extremely valuable for the profession. It is also preferable that an appropriate transition period should be provided for jurisdictions where the pricing practice may have been influenced by the provision of services other than audit to the audit client in the past, a clear divergence to the requirement under R410.6. These are areas that Professional Accountancy Organizations (PAOs), with the support of IESBA, could do more to create awareness among their members as well as the public.

At the same time, the IESBA, IAASB, IFAC, PAOs, as well as other stakeholders can all have a significant role in trying to change the perception that audit is a valuable service and not a mere commodity. Clear communication messages about the relationship between audit quality and fees can continue to be highlighted to management and those charged with governance, as well as to the public.

5. *Do you support that the guidance on determination of the proportion of fees for services other than audit in paragraph 410.10 A1 include consideration of fees for services other than audit:*
  - (a) *Charged by both the firm and network firms to the audit client; and*



(b) *Delivered to related entities of the audit client?*

In general, the SMPC is supportive of this requirement. It gives a more complete picture of the client's significance to the firm and its network. However, we do not believe that all services delivered by network firms will impact the auditor's independence in fact. There will also be practical challenges, e.g., for firms to obtain the necessary information. Indeed, we struggle to understand the potential for fees to related entities to affect auditor independence, since generally the auditor would not have such information.

On this basis, the SMPC suggests IESBA to carefully consider the cost/benefit of including those services delivered to related entities that are of lower significance (in terms of fees or nature).

6. *Do you support the proposal in paragraph R410.14 to include a threshold for firms to address threats created by fee dependency on a non-PIE audit client? Do you support the proposed threshold in paragraph R410.14?*

The SMPC notes that the Board's adoption of a 30% threshold for firms to address threats created by fee dependency is inconsistent with a principles-based Code. We are of the view that the proposed threshold is appropriate for a non-PIE client only on the basis that it is already in place in some jurisdictions while recognizing the fact that the suggested threshold is not scientifically determined. It is thus important for global application that the IESBA commits to review this threshold after a certain period of implementation to assess its effectiveness.

7. *Do you support the proposed actions in paragraph R410.14 to reduce the threats created by fee dependency to an acceptable level once total fees exceed the threshold?*

While we are supportive of the intent behind the proposed actions in paragraph R410.14, we question the rigidity of using a professional accountant who is not and cannot be a member of that firm. If the IESBA has intended this to be a review by "a fresh pair of eyes" (equivalent to a review by a professional body), such requirement may be too rigid in practice, especially for SMPs. This will unnecessarily increase the cost of offering such service, the time to complete the assignment (a luxury not available for many SMPs) and potentially have the consequence of forcing some SMPs out of the audit market. Reducing available options in a marketplace by imposing costly barriers cannot be in the public interest.

8. *Do you support the proposed action in paragraph R410.17 to reduce the threats created by fee dependency to an acceptable level in the case of a PIE audit client?*

For the purpose of consistency (with paragraph R410.14), we suggest that "review by a professional body" should be similarly provided as a possible safeguard. This is despite the Board's contention that it is not too likely to happen in a real-life situation (see paragraph 53 of the Explanatory Memorandum).

Given the heightened state of public interest expected from clients that are PIEs, we are of the view that the use of a professional accountant who is not a member of the firm may be justifiable in this case (paragraph R410.17). However, our response is very much dependent on the outcome of the IESBAs ongoing project relating to the definition of the term PIEs, since not all PIEs defined in local laws and regulations throughout the world carry the same degree of public interest.



9. *Do you agree with the proposal in paragraph R410.19 to require a firm to cease to be the auditor if fee dependency continues after consecutive 5 years in the case of a PIE audit client? Do you have any specific concerns about its operability?*

It appears that this proposal might over-extend the IESBA's authority to set up rules for global application. As a standard-setter, IESBA's proposal may end up stepping into the authority currently vested in those who have the right to appoint auditors, usually on an annual basis (in many jurisdictions, it is usually the shareholders, but not always). For example, in France, this proposal may not be in alignment with local legislation regulating the appointment and resignation of auditors. The reason for the transparency of public disclosure on fees, in our view, is to enable stakeholders and TCWG to make a better decision based on the information as disclosed. We consider that stakeholders can be expected to act in the best interest of the entity and hence, can be seen as an effective safeguard in such a situation.

As mentioned earlier in this letter, we believe that this is a matter of perception that is being dealt with using a rule based rather than a principles-based approach, a departure of what IESBA has been committed to pursue in the restructured Code. As highlighted in our NAS response, we are concerned that the Code is slowly being seen as becoming overly prescriptive as it moves away from being principles based. This in itself creates a risk to the profession.

The SMPC is also concerned that the new rule being proposed could result in unintended consequences and that the undue cost of introducing this proposal will highly exceed the benefit of which it is still unclear. There is also the possibility of increased market concentration of larger firms because of the foreseeable barrier for newly set-up firms to enter the PIE audit market.

On a separate note, should IESBA consider it appropriate to proceed, the SMPC would like to urge the Board to consider the flexibility that can be accorded. In the Board paper of June 2019, there was a proposal that "when determining whether the total fees received from an audit client that is a public interest entity substantially exceeds 15%, the firm shall exercise professional judgment and take into account whether a reasonable and informed third party would likely to reach the same conclusion...". It is much preferable than a "bright line" of 15%. While we will not be debating whether this should belong in a principles-based Code in the first place, we believe that such flexibility may merit some consideration. In our mind, this should not be dealt with in such a way that borderline cases will result in fee pressure to keep the fee below the limit – just to be in compliance with the Code.

10. *Do you support the exception provided in paragraph R410.20?*

Yes, we are supportive of the exception as provided in paragraph R410.20.

11. *Do you support the proposed requirement in paragraph R410.25 regarding public disclosure of fee-related information for a PIE audit client? In particular, having regard to the objective of the requirement and taking into account the related application material, do you have views about the operability of the proposal?*

Yes, we are supportive of the proposed requirement in paragraph R410.25 regarding public disclosure of fees related information for a PIE audit client. We believe this is a powerful mechanism and is definitely a factor to be considered when evaluating the application of safeguards. However, we are also equally



concerned with the practicalities of the proposal and the burden it would place on firms to collate this information on a timely basis.

IESBA will also need to consult appropriately with the IAASB regarding the proposed guidance in 410.25.A4, as content of the audit report is within the remit of the IAASB.

12. *Do you have views or suggestions as to what the IESBA should consider as:*
- (a) *Possible other ways to achieve transparency of fee-related information for PIEs audit clients; and*
  - (b) *Information to be disclosed to TCWG and to the public to assist them in their judgements and assessments about the firm's independence?*

No further comment from the SMPC.

13. *Do you have views regarding whether the proposals could be adopted by national standard setters or IFAC member bodies (whether or not they have a regulatory remit) within the framework of national anti-trust or anti-competition laws? The IESBA would welcome comments in particular from national standard setters, professional accountancy organizations, regulators and competition authorities.*

No further comment from the SMPC. However, we would expect PAOs in each jurisdiction to contact their competition authorities to ensure the feasibility of these fee-related proposals if they foresee any future complication. IESBA may also need to engage further with the wider regulatory community to be able to quantify the impact of all the proposals in the Basis of Conclusions.

14. *Do you support the proposed consequential and conforming amendments to Section 905 and other sections of the Code as set out in this Exposure Draft? In relation to overdue fees from an assurance client, would you generally expect a firm to obtain payment of all overdue fees before issuing its report for an assurance engagement?*

Yes, we are supportive of the consequential and conforming amendments to Section 905 and other sections of the Code.

15. *Do you believe that there are any other areas within the Code that may warrant a conforming change as a result of the proposed revisions?*

No further comment from the SMPC.

## **CONCLUDING COMMENTS**

We hope the IESBA finds this letter helpful in informing the Board's deliberations on the Fees-related provisions. Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

A handwritten signature in blue ink that reads 'Monica Foerster'. The signature is written in a cursive, flowing style.

Monica Foerster  
Chair, SMP Committee