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The International Ethics Standards Board for Accountants
545 Fifth Avenue, 14th Floor
New York, 10017
United States of America

Dear Members of the International Ethics Standards Board for Accountants

EXPOSURE DRAFT – PROPOSED REVISIONS TO THE FEE-RELATED PROVISIONS OF THE CODE (THE EXPOSURE DRAFT)

Thank you for the opportunity to provide comments on the International Ethics Standards Board for Accountants (IESBA) Exposure Draft – *Proposed Revisions to the Fee-related Provisions of the Code* (the Exposure Draft).

The Auditor-General of New Zealand (the Auditor-General) has a particular responsibility to assist the New Zealand parliament to hold the government to account. That responsibility is set out in legislation – the Public Audit Act 2001 (the Act). This response reflects the Auditor-General's perspective on the questions listed in the Explanatory Memorandum dated January 2020, based on the requirements of the Act.

Appendix 1 to our submission provides responses to the questions on which the IESBA has sought comment.

If you have any questions about our submission, please contact Roy Glass (roy.glass@oag.parliament.nz) or me.

Yours sincerely

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Appendix 1 – Response to matters on which the IESBA has sought comments

Request for specific comments

Evaluating Threats Created by Fees Paid by the Audit Client

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)?*

We agree with this statement. Agreeing a reasonable audit fee with an entity is difficult because the intangible benefits of an audit cannot be easily quantified. Those benefits emerge in the confidence parties external to the entity subject to audit place on the value of audited information. There is also the intrinsic value provided to external parties that an entity has been audited.

Entities will often focus attention on the utility of the audit to the entity. Such benefits are easier to quantify and tend to dominate discussions about what is a reasonable audit fee.

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?*

We support this proposal.

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 current model in many jurisdictions, as acknowledged above, is that audit fee negotiations take place between the auditor and entity management and governors, acting on behalf of the shareholders of the entity. Because those who are accountable to the entity's shareholders for their actions (entity management and governors) also carry out these negotiations on behalf of the entity's shareholders, this presents a conflict of interest. This conflict of interest, in the majority of cases, does not impact on the audit-fee negotiation process. However, the negotiation tends to have an entity centric focus as opposed to a public interest focus – when the negotiation needs to strike a suitable balance between entity interests and the wider public interest.

The auditor's bargaining power in the fee-negotiation process is diminished because there is often another auditor ready and waiting to accept the audit on the terms and conditions of the entity negotiators. Entity representatives will sometimes take advantage of this situation to "leverage" audit fee negotiations. Auditors do not want constructive relationships with entity personnel to be soured by overly aggressive audit fee negotiations because those relationships are critical to on-going audit quality.

Although such a model doesn't exist in New Zealand to our knowledge, the presence of an independent "shareholder committee" may remove the conflict of interest when those who are accountable to the entity's shareholders for their actions (entity management and governors) also carry out audit fee negotiations on behalf of the entity's shareholders.

Impact of Services Other than Audit Provided to an Audit Client

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?*

We support this proposal.

Proportion of Fees for Services Other than Audit to Audit Fee

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?*

We support the guidance in paragraph 410.10 A1, although we can find no reference to “services other than audit delivered to related entities of the audit client”.

Different independence requirements for PIE and non-PIE entities

We have a philosophical issue about the application of different independence requirements to public interest entities versus non-public interest entities. This is because the criteria that is used to distinguish public interest entities from non-public interest entities is arbitrary from an audit independence perspective. In addition, in an absolute sense, we do not agree that the stakeholders of PIE entities have heightened expectations regarding an auditor’s independence.

This view tempers our responses to questions 6 to 12.

Fee Dependency for non-PIE Audit Clients

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?*

We 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. We believe that the same threshold should apply to PIE and non-PIE entities.

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?*

The proposed actions in paragraph R410.14 appear to be reasonable.

Fee Dependency for PIE Audit Clients

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?*

The proposed action in paragraph R410.17 appear to be reasonable.

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 5 consecutive years in the case of a PIE audit client? Do you have any specific concerns about its operability?*

The proposal in paragraph R410.19 seems to be appropriate, although we hope a firm would never have to face that situation. Our observation is that a firm must monitor the fee dependency threat

well before the 15% threshold is reached to avoid the very serious consequences for the firm and the entity it is auditing once that threshold is reached.

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

We support the exception provided in paragraph R410.20.

Transparency of Fee-related Information for PIE Audit Clients

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?

We agree with the proposed requirement in paragraph R410.25.

We would advocate more granulated disclosure under R410.25 (b) - fees for services other than audit provided by the firm or a network firm. Under R410.25 (b) a substantial amount of other services may be assurance services that are compulsory. Combining assurance services that are compulsory with other non-assurance services may provide a misleading picture of the total other services provided to the entity. A more helpful disclosure is to include sub-categories of the fees for the different types of other services. Such disclosure may help to reduce the audit expectation gap, especially when a significant portion of the other services are compulsory. A good example is the requirement to audit regulatory reports required by a regulator.

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 judgments and assessments about the firm's independence?

Public transparency of fee-related information about the auditor is very important, as it allows the users of audited information to form their own conclusions about the independence of the auditor. Public transparency is fundamental to the trust relationship that auditors must sustain with those who rely on their work.

Anti-Trust and Anti-Competition Issues

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.

We have no comments on this matter.

Proposed Consequential and Conforming Amendments

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?

The Auditor-General of New Zealand does not recognise Part 4B of the Code (including Section 905) because we apply the more stringent requirements in Part 4A of the Code to all the work of the Auditor-General. We have no comments to make about the proposed consequential amendments to Section 905.

We have no comments about the proposed consequential and conforming amendments to other sections of the Code as set out in the 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?

We would generally expect a firm to obtain payment of all overdue fees before issuing its report for an assurance engagement.

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?*

We have not observed any other areas within the Code that may warrant a conforming change as a result of the proposed revisions.

However, we are of the view that paragraph R410.22 (a) needs to clarify its reference to the “level of the fee”. It is unclear to us whether that refers to the “cost of the audit to the firm” or to “the fees that have been charged to the entity for the audit”? If it is the former that is important information that allows the auditor to have a meaningful discussion with TCWG about the true cost of the audit, in relation to the fee that has been charged.

Request for General Comments

Small- and Medium-Sized Entities (SMEs) and Small and Medium Practices (SMPs) – *The IESBA invites comments regarding any aspect of the proposals from SMEs and SMPs.*

New Zealand is a small country with a population of less than 5 million people. New Zealand is dominated by SMPs, and our responses to the questions raised by the IESBA reflect a SMP perspective.

Developing Nations – *Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular on any foreseeable difficulties in applying them in their environment.*

Developing nations face difficulties in applying the requirements of the Code when both auditing and financial reporting expertise is in short supply.

Translations – *Recognizing that many respondents may intend to translate the final changes for adoption in their own environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposals.*

We have no comments to make on potential translation issues.