

ETHICAL CONSIDERATIONS RELATING TO AUDIT FEE SETTING IN THE CONTEXT OF DOWNWARD FEE PRESSURE

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Purpose of this Publication

1. The purpose of this IESBA Staff publication is to highlight auditors' ethical obligations under the Code as one of the important considerations when setting audit fees, specifically in circumstances of downward pressure on fees. This paper will be of relevance to auditors when considering tendering for a new audit engagement, or when proposing or agreeing fees for recurring audit engagements. The paper may also be of interest to those charged with governance (TCWG), preparers, regulators and audit oversight bodies, investors, and others with an interest or role in auditors' work and their independence.
2. While this paper focuses on certain provisions of the Code that are relevant to the matter of downward fee pressure, it does not address other provisions relating to fees that are contained in the Code.

Topics Discussed in this Publication

- Reasons for downward pressure on audit fees
- Key considerations in the Code
 - Compliance with the fundamental principles
 - Communication with those charged with governance
- Importance of the role of other stakeholders
- National guidance

¹ References to the Code in this publication are to the Code extant as of the date of this publication. The Code can be accessed at: <http://www.ethicsboard.org/iesba-code>.

Introduction

3. Various factors affect audit fees, including the nature, size and complexity of the audit, the reporting requirements for the particular engagement or in the particular jurisdiction, and market competition. At the level of the audit engagement, decreases in audit fees may arise because of a reduction in the audit scope (such as through the entity's divestment of components or business lines), fewer complexities in the audit, and efficiencies in the audit methodology and audit process.
4. However, pressures on audit fees charged or proposed for a given engagement may arise for different reasons. These include efforts by the entity to reduce costs; and increased competition in segments of the audit market as a result of regulatory developments such as mandatory firm rotation, retendering or increased thresholds below which the statutory audit is not required.
5. Downward pressure on audit fees can have ethical implications for auditors. This paper therefore highlights key ethical considerations under the Code for auditors of entities of all sizes.

Key Ethical Considerations under the Code

6. The setting of audit fees is a commercial matter to be agreed between auditors and audited entities. Indeed, the Code states that when entering into negotiations regarding professional services, an auditor may quote whatever fee is deemed appropriate. It also states that the fact that one auditor may quote a fee lower than another is not in itself unethical.² However, the Code does caution that there may be threats to compliance with the fundamental principles arising from the level of fees quoted.³

Compliance with the Fundamental Principles

7. The overriding obligation for all auditors under the Code is to comply with the fundamental principles.⁴ Of particular importance when auditors face downward pressure on audit fees is adherence to the fundamental principles of professional competence and due care, and objectivity.

Professional Competence and Due Care

8. The Code notes that a self-interest threat to professional competence and due care is created if the fee quoted is so low that it may be difficult to perform the engagement in accordance with applicable technical and professional standards for that price.⁵
9. Competent professional service requires the exercise of sound judgment in applying professional knowledge and skill in the performance of the service.⁶ Due care encompasses the responsibility to act diligently in accordance with applicable technical and professional standards, and with the

² IESBA Code, paragraph 240.1

³ IESBA Code, paragraph 240.1

⁴ Integrity, objectivity, professional competence and due care, confidentiality, and professional behavior (IESBA Code, paragraph 100.5)

⁵ IESBA Code, paragraph 240.1

⁶ IESBA Code, paragraph 130.2

requirements of an assignment carefully, thoroughly and on a timely basis.⁷ The Code specifically calls for firms to take reasonable steps to ensure that those selected to be part of the engagement team have appropriate training and supervision.⁸

10. In circumstances of fee pressure, it is important that auditors pay particular attention to two key considerations in complying with the fundamental principle of professional competence and due care. These are that, regardless of the audit fee:

- (a) Adequate time should be planned and spent to enable the audit to be performed in accordance with applicable technical and professional standards; and
- (b) Audit personnel with sufficient expertise and experience should be assigned in accordance with the nature, size and complexity of the audit engagement.

Key Messages

- Auditors should perform high quality audits regardless of the level of the audit fees.
- In particular:
 - Adequate time should be planned and spent to enable the audit to be performed in accordance with applicable technical and professional standards.
 - Audit personnel with sufficient expertise and experience should be assigned in accordance with the nature, size and complexity of the audit engagement.
- TCWG, management, regulators and audit oversight bodies, and investors have an important role to play in ensuring that financial considerations relating to audit fees do not create threats to auditors' compliance with their ethical obligations. In particular, two-way communication between TCWG and auditors may be especially helpful to enable TCWG to appreciate any identified threats arising from undue fee pressures and consider the appropriateness of any safeguards applied by the auditors. Such communication is also important to assist TCWG in considering appropriate actions they and the entity's management can take to mitigate those threats.

11. For example, when entities face economic difficulty, auditors may encounter more challenging audit areas that require additional work and more extensive exercise of professional judgment and greater skepticism. These areas

may include, for example, assessing whether an entity is able to continue as a going concern, evaluating whether there are impairments in asset values, and estimating fair values for illiquid assets. Changes in an entity's business and in financial reporting requirements may also give rise to more complex judgments and the need for additional work effort. Circumstances such as these increase the time and level of expertise and experience needed on audit engagements.

12. The principle of professional competence and due care also imposes an obligation on all professional accountants to maintain professional knowledge and skill at the level required to ensure that audited

⁷ IESBA Code, paragraphs 130.1(b) and 130.4

⁸ IESBA Code, paragraph 130.5

entities receive competent professional service.⁹ The Code explains that the maintenance of professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. It also explains that continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.¹⁰ In an environment of heightened pressures on audit fees, it is therefore particularly important for auditors to maintain a focus on continuing professional development, and to retain or recruit audit personnel with the knowledge, skills and training that will enable them to perform their audits in accordance with applicable technical and professional standards.

Objectivity

13. The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others.¹¹
14. The Code notes that an intimidation threat may be created when an auditor is pressured to inappropriately reduce the extent of work performed in order to reduce fees.¹² This may arise, for example, in times of economic difficulty when entities may be under significant pressure to reduce costs. Circumstances such as this may in particular threaten the auditor's compliance with the fundamental principle of objectivity, as well as the fundamental principle of professional competence and due care.

Communication with TCWG

15. The Code encourages regular communication between auditors and TCWG regarding relationships and other matters that might, in the auditors' opinion, reasonably bear on independence. It notes that this can be particularly helpful with respect to intimidation threats¹³ (as may be created, for instance, from management pressure to reduce audit costs).
16. In the context of undue fee pressures, auditors may consider it appropriate to discuss with TCWG such threats to compliance with the fundamental principles. This discussion would enable TCWG to recognize and understand those threats. It would also enable them to consider the auditors' judgments in evaluating those threats and the appropriateness of any safeguards applied to eliminate the threats or reduce them to an acceptable level. The discussion is also important to assist TCWG in considering appropriate actions they and the entity's management can take to mitigate such threats.

⁹ IESBA Code, paragraph 130.1(a)

¹⁰ IESBA Code, paragraph 130.3

¹¹ IESBA Code, paragraph 120.1

¹² IESBA Code, paragraph 200.8

¹³ IESBA Code, paragraph 290.28

Importance of the Role of Other Stakeholders

17. The [Audit Quality Framework](#) issued by the International Auditing and Assurance Standards Board (IAASB) notes that there is usually a relationship between the quality of an audit and the quality and quantity of the resources used in its performance (as usually reflected in the audit fee).¹⁴ While auditors have a primary responsibility for the quality of the audits they perform, other stakeholders have an equally important role to play in ensuring that financial considerations in relation to audit fees do not drive actions and decisions that impair audit quality.
18. In particular, it is important that TCWG consider whether adequate time and resources are planned for the nature and scope of the particular engagement when audit fees are being negotiated, and that they engage in dialogue with auditors and management in this regard. Management has an important role to play in facilitating an efficient audit process. Management and TCWG should also recognize that high quality audits are an essential part of the proper running of their entities' business and should not view the audit as merely a cost to be minimized. Also, regulators and audit oversight bodies have an important role to play in setting the appropriate tone vis-à-vis management and TCWG to ensure that considerations regarding audit fees do not give rise to threats to auditors' compliance with their ethical obligations, and ultimately compromise audit quality. And investors have a role to play in demanding quality audits for a reasonable price.
19. The IAASB's Audit Quality Framework further discusses the role of these and other stakeholders in contributing to an environment that positively supports audit quality.

National Guidance

20. In some jurisdictions, national guidance on the topic of fee pressure and related ethical considerations may be available. Auditors may find it helpful to refer to such guidance where available, in addition to this staff publication, when considering tendering for new audit engagements, when proposing or agreeing fees for recurring audit engagements, and when planning and performing the audit.

¹⁴ Audit Quality Framework, paragraph 110

Key Contacts

James Gunn, Managing Director, Professional Standards (jamesgunn@ProfStds.org)

Ken Siong, Technical Director (kensiong@ethicsboard.org)

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