IESBA Exposure Draft:

‘Proposed Revisions to the Fee-related Provisions of the Code’

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Introduction

ICAS is a professional body for more than 22,000 world class business men and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

Almost two thirds of our working membership work in business; many leading some of the UK's and the world's great companies. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854. The ICAS Charter requires its Boards to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

The ICAS Ethics Board has considered the IESBA Exposure Draft: 'Proposed Revisions to the Fee-related Provisions in the Code' and I am pleased to forward its comments.

Any enquiries should be addressed to Ann Buttery, ICAS Head of Ethics.

Key Points

Overall, we are generally supportive of IESBA's proposals outlined in the above Exposure Draft and believe that the new provisions will be beneficial to users of the Code.

We 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 would however suggest that IESBA move away from the term "audit client" in this context and instead use the term "audited entity". "Audited entity" is the term used by the UK Financial Reporting Council (FRC) Ethical Standard. The audit client is the shareholders.

We support the requirement for a firm to determine whether the threats to independence created by the fees proposed to an audit client are at an acceptable level before the firm, or network firm, accepts the engagement.

And we also agree that a firm should 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

However, whilst we believe that IESBA is heading in the right direction in relation to its proposals on fee dependency, and we acknowledge that IESBA has to balance different market structures internationally, we believe, from a UK perspective, that the 30% limit on fees received from a non-PIE audit client could be lower.

We also question for audit clients that are not PIEs whether a reasonable and informed third party would consider it appropriate that fee dependency can continue for a period of five years before the firm is required to determine whether a review might be a safeguard. We would suggest that a threshold of 20% and three years may be more appropriate. This would still allow for proportionality as the provisions for audit clients that are non-PIEs are still less rigorous than the provisions for audit clients that are PIEs. We would also suggest that it might be helpful for clarification as to the exact nature of the "reviews" described in R410.14, for example, whether there might be merit in an external independent quality review being undertaken.

We agree that the determination of the proportion of fees for services other than audit 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. However, we believe that there could be more detail in the application material in order to improve clarity.

We support the proposals for transparency of fee information to those charged with governance and the public disclosure of fee information. We note some suggestions where we believe the provisions could be clearer.

Within our responses to the specific questions we also note several drafting suggestions for IESBA's consideration which we believe would help clarify IESBA's intentions within the provisions.

Responses to the Specific Questions

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)?

Yes – we 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 would however suggest that IESBA move away from the term "audit client" in this context and instead use the term "audited entity". "Audited entity" is the term used by the UK FRC Ethical Standard. The audit client is the shareholders.

A self-interest threat is defined in the Code at 120.6 A3 as "the threat that a financial or other interest will inappropriately influence a professional accountant's judgement or behaviour." We believe that when someone is paying you for the services you are providing there is a financial interest involved in that relationship, and therefore, by the very nature of this relationship, there is an inherent self-interest threat. We would add that there is also a public perception that because auditors are paid by their clients they might be beholden to those clients.

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 - we 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 note that ISQC 1 (UK) paragraph 27-2 also states: "Before accepting or continuing an engagement for an audit engagement of a public interest entity, or an other entity of public interest, the firm shall also assess the following: (a) Whether the firm complies with the audit fees and the prohibition of the provision of non-audit services requirements in the FRC's Ethical Standard…"

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 evaluation of fees is a two-way engagement between the audit firm and those charged with governance of a client. For example, the UK Corporate Governance Code requires listed companies to establish an audit committee of independent non-executive directors which, amongst other matters, is required to oversee the company's relations with its external auditors including the negotiation and monitoring of fee dependency and ratio of audit to non-audit work fees. In turn, the FRC Ethical Standard requires auditors to provide details of non-audit / additional services provided and the fees charged.

We would support recognising 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.

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?

Yes – we agree with the requirement in paragraph R410.6 that a firm should 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.

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 agree with the substance of paragraph 410.10 A1, and that determination of the proportion of fees for services other than audit 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.

However, we believe that there could be more clarity in the application material.

For example, there are no specific provisions proposed for PIEs. In contrast, the UK FRC's Ethical Standard has very detailed provisions as to what should be included within the calculation for PIEs in terms of the firm and its networks; the client and its related parties; and the services other than audit.

One of the factors to consider in paragraph 410.10 A2 is "the ratio of fees for services other than audit to the audit fee". However, we suggest a distinction could be made between "non-audit services" and "audit related services" where audit related services, such as reporting required by law or regulation, which are closely related to the work performed in the audit, are generally considered to pose insignificant threats to auditor independence.

We also note that paragraph 44 of the Explanatory Memorandum states the following:

"44. For the avoidance of doubt, the IESBA intends that the related entity provision of the Code (paragraph R400.20) would apply in determining the fees for other services provided to the audit client, i.e., services provided to related entities of the audit client would be included."

Paragraph R400.20 states:

"As defined, an audit client that is a listed entity includes all of its related entities. For all other entities, references to an audit client in this Part include related entities over which the client has direct or indirect control. When the audit team knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team shall include that related entity when identifying, evaluating and addressing threats to independence."

This definition then flows through into the provisions on fees for other services provided to the audit client, and fee dependency. However, for example, when considering paragraphs 410.10 A1 and 410.13 A1 in isolation, whilst the paragraphs may be logically correct in terms of capturing applicable related entities as per R400.20, we would highlight that it is not immediately clear to the user that applicable related entities are within scope.

To be aware of the extent to which entities are covered by the term "audit client" within these paragraphs, the user has to go through a convoluted process of referring to the definition of "audit client" within the Glossary and then to paragraph R400.20. We believe users may find this cumbersome, and there is therefore a risk that they may not conclude upon the full extent of related entities that are within scope.

We also note that the definition of "Audit Client" within the Glossary refers to paragraph R400.20, however the definition of "Audit Client" does not flag that there is an additional aspect to paragraph R400.20 as it also states: "When the audit team knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team shall include that related entity when identifying, evaluating and addressing threats to independence."

We would also add that where paragraphs are crucial to allow a full assessment of any proposed revision to the Code if would be helpful for the paragraph to be included in the Exposure Draft for ease of reference. In this particular instance, we would highlight paragraph R400.20 as an example.

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?

In principle we support the proposal in paragraph R410.14 and the inclusion of a threshold for firms to address threats created by fee dependency on a non-PIE audit client. We acknowledge that the 30% limit on fees received from a non-PIE audit client has been introduced where previously there was no % limit at all for non-PIE audit clients.

However, whilst we recognise that IESBA has to balance different market structures internationally, we believe, from a UK perspective, that the % limit could be lower. For example, in the equivalent provisions within the FRC's Ethical Standard there is a threshold of 15% for non-listed audit clients that are not PIEs. We also question whether a reasonable and informed third party would consider it appropriate that fee dependency can continue for a period of five years before the firm is required to determine whether a review might be a safeguard. We would suggest that a threshold of 20% and three years may be more appropriate. This would still allow for proportionality as the provisions for audit clients that are non-PIEs are still less rigorous than the provisions for audit clients that are PIEs.

We also note the following in relation to the wording of paragraphs R410.17 and R410.24 regarding fees generated at a group level in the case of audit clients that are PIEs, which could also impact paragraph R410.14 for audit clients that are not PIEs.

Paragraph 55 of the Explanatory Memorandum states:

*"*Regarding the fees generated at a group level, the IESBA agreed that firms should consider fees from related entities of the audit client in calculating the total fees from the client, in accordance with the related entity provision of the IIS (paragraph R400.20)."

The footnote to paragraph 55 goes on to say: "The IESBA notes that this proposal is not intended to differ from the approach taken in the extant Code, even though the extant requirement (paragraph R410.4) includes an explicit reference to "fees from the audit client and its related entities."

If, as per paragraph 55 of the Explanatory Memorandum, IESBA's intention is that that "firms should consider fees from related entities of the audit client in calculating the total fees from the client", we believe this intention could be clarified within the provisions. Similar to the comments in our response to Question 5 above, whilst IESBA's approach in the provisions is logically correct, and captures applicable related entities as per R400.20, we would highlight that it is not immediately clear to the user when considering the various requirements in this section in isolation that applicable related entities are within scope. The removal of the explicit reference in the Code might also lead the user to believe that there has been a change in the scope of the requirement.

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?

We support the substance of IESBA's proposal and agree that the firm shall determine whether the reviews as described in R410.14 (a) and R410.14 (b) might be safeguards. However, we would suggest that it might be helpful for clarification as to the exact nature of the "reviews" described in R410.14, for example, whether there might be merit in an external independent quality review being undertaken.

From a UK perspective, when there is a concern over fee dependency in relation to a non-listed entity that is not a PIE, the FRC Ethical Standard requires an external independent quality control review of the engagement to be undertaken before the firm's report is finalised:

"4.24 Where it is expected that the total fees for services receivable from a non-listed entity that is not a public interest entity and its subsidiaries relevant to a recurring engagement by the firm will regularly exceed 15% of the annual fee income of the firm or, where profits are not shared on a firm-wide basis, of the part of the firm by reference to which the engagement partner's profit share is calculated, the firm shall not act as the provider of the engagement for that entity and shall either resign or not stand for reappointment, as appropriate.

4.31 Where it is expected that the total fees for services receivable from a non-listed entity, that is not a public interest entity, and its subsidiaries relevant to a recurring engagement will regularly exceed 10% of the annual fee income of the firm or the part of the firm by reference to which the engagement partner's profit share is calculated, but will not regularly exceed 15%, the engagement partner shall disclose that expectation to the Ethics Partner/Function and to those charged with governance of the entity and the firm shall arrange an external independent quality control review of the engagement to be undertaken, before the firm's report is finalised."

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?

Yes – similar to our response to Question 6 - in principle we support the proposal in paragraph R410.17. We note the FRC's Ethical Standard states:

"4.23 Where it is expected that the total fees for services receivable from a public interest entity or other listed entity and its subsidiaries relevant to a recurring engagement by the firm will regularly exceed 10% of the annual fee income of the firm or, where profits are not shared on a firmwide basis, of the part of the firm by reference to which the engagement partner's profit share is calculated, the firm shall not act as the provider of the engagement for that entity and shall either resign or not stand for reappointment, as appropriate.

4.27 Where it is expected that the total fees for services receivable from a public interest entity or other listed entity and its subsidiaries relevant to a recurring engagement by the firm will regularly exceed 5% of the annual fee income of the firm or the part of the firm by reference to which the engagement partner's profit share is calculated, but will not regularly exceed 10%, the engagement partner shall disclose that expectation to the Ethics Partner/Function and to those charged with governance of the entity, including the audit committee where there is one, and discusses with both the threat to integrity, objectivity and independence of the firm and covered persons and whether safeguards need to be applied to eliminate or reduce the threat to a level where independence would not be compromised.

4.30 Such safeguards might include: • taking steps to reduce the other work to be undertaken and therefore the fees earned from the entity; • applying independent internal quality control reviews."

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?

Yes – we agree with the proposal in paragraph R410.19 to require a firm to cease to be the auditor if fee dependency continues in the case of a PIE audit client after 5 consecutive years.

Further we note that paragraph 59 of the Explanatory Memorandum states the following: "In relation to this proposed requirement in paragraph R410.19, the IESBA noted that in some jurisdictions, laws or regulations might prohibit firms from resigning as auditor from a client relationship. The IESBA agreed that the Code already addresses such a circumstance in the overarching requirement in Section 100 to the effect that the Code cannot override laws and 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."

The local laws and regulations override is not mentioned in paragraph R410.19. However, we believe that it would be more helpful to users if R410.19 did specifically address this matter. We note that there is a specific paragraph in the proposed new provisions in IESBA's Exposure Draft: "Proposed Revisions to the Non-Assurance Services Provisions of the Code", which states: "600.6 A1 Paragraphs R100.3 to 100.3 A2 set out a requirement and application material relating to compliance with the Code. If there are laws and regulations in a jurisdiction relating to the provision of non-assurance services to audit clients that differ from or go beyond those set out in this section, firms providing non-assurance services to which such provisions apply need to be aware of those differences and comply with the more stringent provisions."

We suggest the following wording for R410.19:

"R410.19 Subject to paragraphs R100.3 to 100.3 A2 and paragraph R410.20, if the circumstances described in paragraph R410.17 continue for five consecutive years, the firm shall cease to be the auditor after the audit opinion for the fifth year is issued."

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

We agree with the exception provided in paragraph R410.20. We agree that it is helpful to have a mechanism whereby the auditor can seek approval to continue with an engagement after five consecutive years if it is in the public interest.

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 support the proposals for transparency of fee information to those charged with governance and the public disclosure of fee information. We note some suggestions in the response to Question 12 where we believe the clarity of the provisions could be improved upon.

Similar to paragraph R410.19 above, we believe there needs to be further clarification re the interaction with laws and regulations. It is alluded to in paragraph R410.25 but not to the extent as is explained in paragraph 80 of the Explanatory Memorandum, which might be more helpful to users:

"Para 80. First, the IESBA recognizes that several jurisdictions already have laws and regulations regarding public disclosure of fee-related information. Also, in certain circumstances, laws and regulations might prohibit public disclosure. In those instances, consistent with the overarching provision in paragraph R100.3 of the Code, laws and regulations prevail. As it is not always possible to determine whether laws and regulations differ or go beyond the provisions of the Code regarding the extent of the information to be disclosed, to avoid duplication of obligations in relation to public disclosure, the proposal recognizes compliance with such laws and regulations as compliance with the Code if those national requirements substantively satisfy the requirement in the Code. (See paragraphs R410.25 and 410.25 A2.)"

Suggested wording:

In accordance with the overarching provision in paragraph R100.3, jurisdictional laws and regulations prevail. The requirements in subparagraphs (a) and (b) above may be met by compliance with laws and regulations which substantively satisfy the ~~the~~ ~~corresponding~~ requirements in these subparagraphs.

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?

We note some matters that could be clarified in relation to the "Communication About Fee-related information with Those Charged with Governance" paragraphs:

- Paragraph R410.22 states that "the firm shall communicate in a timely manner with those charged with governance". We would suggest that it might be helpful if the Code could indicate that communication with TCWG regarding fee-related information should, at least, take place at the conclusion of the engagement. For example, we note that the FRC's Ethical Standard paragraph 1.59 specifically states: "The most appropriate time for these final written confirmations of independence is usually at the conclusion of the engagement." Communication with TCWG regarding fees may, of course, require to be more often if, for example, non-assurance services are being provided.
- In paragraphs 410.22, it would be helpful to provide more clarity regarding whether it is fees for the firm and its network firms charged to the audited entity and its related entities. For example, FRC Ethical Standard paragraph 1.61 states: "For an audit engagement, the engagement partner ensures that the total amount of fees that the firm and its network firms have charged to the audited entity and its affiliates for the provision of services during the reporting period, analysed into appropriate categories are disclosed."

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.

From a UK perspective, we are not aware that the IESBA proposals would create anti-trust or anti-competition issues.

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? 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 support the proposed consequential and conforming amendments to Section 905. We note there has been a strengthening of the provisions in paragraph 905.8 A1 reflecting the equivalent paragraph in Section 410 - 410.11 A2. We support this change.

Yes - we would generally expect a firm to obtain payment of overdue fees before issuing its report for an assurance engagement, unless the amount could be regarded as trivial.

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 do not believe there are any other areas within the Code requiring a conforming change.