

July 2022



Basis for Conclusions: Amendments to the Fee-related provisions in APES 110 Code of Ethics for Professional Accountants (including Independence Standards)

Prepared by the Technical Staff of the Accounting Professional & Ethical Standards Board

BASIS FOR CONCLUSIONS:

Amendments to the Fee-related provisions in APES 110 Code of Ethics for Professional Accountants (including Independence Standards)

This basis for conclusions has been prepared by Technical Staff of Accounting Professional & Ethical Standards Board Limited ("APESB"). It has been reviewed and approved by the Board of Directors of APESB and is provided for the benefit of stakeholders to gain an understanding of the background to the revision of the fee-related provisions in APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code).

The basis for conclusions **does not** form part of APES 110 and is not a substitute for reading the Code.

Background

The International Ethics Standards Board for Accountants (IESBA) issues the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the International Code), upon which APESB bases its Code.

The revisions to the existing fee-related provisions in the Code have been driven from the following sources:

1. IESBA's revisions to the fee-related provisions in the International Code;
2. amendments to the International Code for the Australian context;
3. APESB's response to recommendations raised in a Parliamentary Joint Committee Inquiry into the Regulation of Auditing in Australia; and
4. amendments to address requests from regulators to include a threshold in relation to fee dependency on a referral source of multiple audit clients.

In May 2021, APESB issued Exposure Draft (ED) 03/21 *Proposed Amendments to Fee-related provisions of APES 110 Code of Ethics for Professional Accountants (including Independence Standards)* (ED 03/21).

APESB received 19 submissions in response to ED 03/21 from a broad range of respondents, including small-to-medium-practices (SMPs), mid-to-large accounting firms, professional organisations and regulators. The submissions generally supported the proposals in the exposure draft, apart from concerns with the proposed revisions relating to fee dependency on a referral source.

After substantial further stakeholder engagement, APESB developed revised fee dependency provisions which were re-exposed in Exposure Draft (ED) 01/22 *Proposed Amendments to Fee-related provisions of APES 110 Code of Ethics for Professional Accountants (including Independence Standards)* (ED 01/22).

APESB received seven submissions in response to ED 01/22 from professional organisations, firms and a regulator, which generally supported the revised provisions.

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The details of significant changes made, the key issues raised by respondents and stakeholders during the revision of fee-related provisions of the Code and how APESB addressed them are set out below.

(a) IESBA's revisions to the International Code

The IESBA commenced a project to revise the fee-related provisions in its Code in September 2018. The project considered enhancements to the fee-related provisions of the International Code so they remain robust and appropriate and would enable professional accountants to comply with the fundamental principles and be independent.

The final pronouncement, *Revisions to the Fee-related Provisions of the Code*, was released by the IESBA in April 2021 and is effective for engagement periods beginning on or after 15 December 2022, with early adoption permitted.

The significant changes in this pronouncement were to:

- Articulate and address the issue of threats to Independence created when fees are negotiated with and paid by the Audit or Assurance Client.
- Clarify that the audit fee should be a standalone fee within the spectrum of total fees from the Audit Client so that the provision of services other than audit does not influence the level of the audit fee.
- Provide guidance for Firms to evaluate and address the threats to Independence created when a large proportion of total fees charged by the Firm or Network Firms to an Audit Client is for services other than an audit.
- Enhance the provisions regarding fee dependency both when Audit Clients are Public Interest Entities (PIEs) and when they are non-PIEs, including establishing a threshold for addressing threats in the case of non-PIE audit clients.
- Require the Firm to cease to be the auditor for a PIE Audit Client if circumstances of fee dependency continue beyond a certain period.
- Enhance transparency with regard to fee-related information for PIE Audit Clients to assist Those Charged with Governance (TCWG) and the public in forming their views about the Firm's Independence.
- Enhance the robustness of guidance in the Code regarding factors to evaluate the level of the threats created when fees are paid by an Audit or Assurance Client and safeguards to address such threats.

In conjunction with the release of the IESBA's amending standard on the fee-related provisions, the IESBA have released a [Basis for Conclusions Document](#).

The changes to the International Code were adopted into the Code with no substantive changes made as a result of the exposure draft due process.

(b) Amendments to the International Code for the Australian context

In March 2021, APESB determined to develop APES 320 *Quality Control for Firms* into a specific quality management standard for firms providing non-assurance services, ensuring it maintains consistency with the firm-level components of the quality management standards issued by the Auditing and Assurance Standards Board (AUASB). This approach means that depending on the services provided by the Member in Public Practice or the Firm, APES 320 and/or the quality management standards issued by the AUASB will be applicable.

Due to the APES 320 development process, APESB initially included references to quality management standards in the fee-related provisions in the Code to incorporate both quality management standards applicable in Australia. The revised APES 320 *Quality Management for Firms that Provide Non-Assurance Services* was issued in March 2022. In the context of audits, reviews and other Assurance Engagements, from 15 December 2022 only AUASB's quality management standards will be applicable. Accordingly, conforming amendments to the relevant fee-related provisions of the Code are proposed by the APESB.¹

(c) APESB's response to recommendations raised in a Parliamentary Joint Committee Inquiry into the Regulation of Auditing in Australia

In 2019, a Parliamentary Joint Committee Inquiry (the PJC Inquiry) commenced considering audit regulation in Australia. The PJC held public hearings in 2019 and 2020, resulting in the issue of an interim report and a final report in February and November 2020, respectively. The Final Report reconfirmed the recommendations set out in the Interim Report. However, the Federal Government is yet to release a response to the PJC's recommendations.

Two recommendations related to matters relevant to APESB.

Recommendation 3 of the PJC Inquiry related to the development of:

- defined categories for the disclosure of audit and non-audit services; and
- a list of non-audit services that firms are explicitly prohibited from providing.

The first tranche of this recommendation has two main elements: the auditor remuneration disclosure requirements and the definitions of categories to be included in the disclosure.

¹ [Proposed Quality Management-related Conforming Amendments to APES 110 Code of Ethics for Professional Accountants \(including Independence Standards\)](#).

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In response to this recommendation, the Australian Accounting Standards Board (AASB) published Research Report 15 – *Review of Auditor Remuneration Requirements* in February 2021. This report focuses on improving the current Australian disclosure requirements having regard to cost/benefit considerations. The report recommends the introduction of five key categories for audit services and fees, which are:

- Audit Services;
- Audit-Related Services;
- Other Assurance Services;
- Tax Services; and
- Other Services.

APESB proposed incorporating guidance on the categories of services and what would be included within each category in the Code. This will be a useful guide for auditors to consider how different services affect their independence and compliance with the fundamental principles of the Code.

The AASB are still progressing its project and APESB has agreed to defer the inclusion of guidance in the Code on fee categories to align with the timeline of the AASB's project. This deferral was in line with suggestions made by stakeholders as part of the exposure draft due process.

APESB will address the second tranche of this PJC recommendation about a list of prohibited non-audit services in its project to amend the non-assurance services provisions of the Code.

Recommendation 5 of the PJC Inquiry related to the Incentivisation of Audit Partners. The extant Code prohibited audit partners from being incentivised to sell non-assurance services to their audit clients. However, to address this recommendation, the significant change to the Code is that the extant requirement has been broadened in Australia to prohibit audit partners from incentivising, either directly or indirectly, to sell non-assurance services to all audit clients of the Firm.

(d) Amendments to address requests from regulators to include a threshold in relation to fee dependency on a referral source of multiple audit clients

The referral source provisions in the Code are Australian additions included in 2013 to primarily address the self-managed superannuation fund (SMSF) sector. APESB received requests from regulators for the Code to be more prescriptive about what would represent a large proportion of fees when considering fee dependency on one referral source of multiple clients.

The regulators recommended a threshold of 20% should be included to provide clarity when a referral source represents a large proportion of fees for a firm, an individual partner or an office within the firm, particularly in the SMSF sector.

The respondents' views on the initial proposals were mixed, with respondents generally supportive of the provision of guidance, but there were concerns about how the requirements would be implemented and enforced in practice.

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APESB then determined to develop revised provisions based on the International Code provisions for fee dependency concerning a single non-PIE audit client (paragraphs R410.15 and R410.16). This approach also ensured that the threats associated with fee dependency are treated consistently, whether the dependence is on one referral source or one audit client. The re-developed provisions included:

- an increase of the proposed threshold to 30% (up from 20%);
- the addition of a five-year cumulative time period to be met before the requirement is to be applied;
- a definitive action that must be taken at the five-year mark; and
- a new requirement to clarify the position when fee dependency continues past the initial five-year cumulative period.

There were two key matters raised by stakeholders on the revised provisions, being:

(a) The length of the time period

Some stakeholders supported the five-year period. However, others were concerned that five years is too long before SMSF auditors need to address the threat created to the auditor's independence by fee dependency.

However, there is an overarching requirement in the Code that requires Members in Public Practice to identify, evaluate and address threats to independence when it is necessary. This is not dependent on meeting specified factors, so Members who have a dependency on fees from a referral source over a couple of years should be alert to the need to apply the conceptual framework to address threats to the fundamental principles and independence.

APESB did not receive compelling evidence via the exposure draft due process to conclusively determine that the requirement should be shorter than the time period used in assessing fee dependency for a single non-PIE audit client (paragraph R410.15). However, to address this concern, APESB has removed the ability to perform a post-issuance review at the five-year mark and only allowed a pre-issuance review.

(b) The action to take when the factors in the requirement were met

ED 01/22 identified three potential options for actions that could be undertaken to address threats to independence. The options were to:

1. have an appropriate reviewer who was not involved in the audit engagement review the audit work (which is a suggested safeguard in paragraph 410.14 A7);
2. require a review to be completed in line with the guidance in ASQM 2 *Engagement Quality Reviews* issued by the AUASB; or
3. perform a compliance engagement to provide assurance that the fee dependency does not impact the auditor's independence.

Stakeholders provided mixed views in relation to the proposed options for actions to be taken after five years of fee dependency, recognising that there needed to be

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flexibility for the action to suit the specific circumstances of the engagement without imposing heavy compliance burdens on the auditor. Some stakeholders were of the view that all three options could therefore be included in the Code.

APESB has determined that having an appropriate reviewer who was not involved in the audit engagement review the work (i.e., Option 1) will be adopted in the Code. This option allows the reviewer to determine the work that needs to be performed without requiring the Code to be prescriptive on the specific type of review or engagement and how it should be performed. Adopting this option does not preclude the appropriate reviewer from choosing to complete a review or compliance engagement as described in Options 2 and 3 above.