

AGENDA PAPER

Item Number: 11

Date of Meeting: 4 March 2021

Subject: Proposed revision to APES 110 for Fee-related provisions of the Code.

Action required For discussion For noting For information

Purpose

For the Board to consider the draft exposure draft which proposes revisions to the fee-related provisions of APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code) including:

- revisions to align with international developments;
- options to address the recommendations from the inquiry into the regulation of audit in Australia undertaken by the Parliamentary Joint Committee on Corporations and Financial Services (PJC Inquiry); and
- the request from a regulator to include a threshold in the AUST provision relating to the referral of multiple audit clients from one source.

Background

In January 2016, the International Ethics Standards Board for Accountants (the IESBA) released the Staff Publication, [Ethical Considerations Related to Audit Fee Setting in the Context of Downward Fee Pressure](#), which considered matters relating to fees and the impact it has on the ethical behaviour of professional accountants.

The IESBA subsequently approved a [Fees Project Proposal](#) in September 2018 and released an Exposure Draft in January 2020.

APESB carried out two Australian stakeholder engagement activities in April 2020 that gathered valuable input to inform the [APESB's Submission to IESBA on Proposed Revisions to the Fee-related Provisions of the Code](#).

At the November 2020 Board meeting, APESB Technical Staff provided the Board with an update on the IESBA's Fees Exposure Draft and a summary of global feedback on the proposals (refer to [Agenda Item 2](#)).

In December 2020, the IESBA approved the final text of the amendments to fee-related provisions of the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the IESBA Code). The IESBA final text is awaiting final approval from the Public Interest Oversight Board (PIOB) at its next meeting on 22 and 23 April 2021. Once the text is approved, the IESBA will issue the final pronouncement in May 2021, with an effective date of 15 December 2022.

While these developments were taking place internationally, locally in 2019, the PJC Inquiry commenced considering audit regulation in Australia. The PJC held public hearings in 2019 and 2020 and subsequently issued an interim report in February 2020.

The Final Report of the PJC was released in November 2020, which reconfirmed the recommendations set out in the Interim Report. At the date of writing this report, the Federal Government is yet to release a response to the PJC's recommendations.

Key Considerations

To maintain alignment with the IESBA Code, Technical Staff are proposing to issue for exposure the revisions to the fee-related provisions of the Code.

To facilitate the efficient and timely release of this ED once the IESBA issues their final pronouncement in due course, Technical Staff have prepared a draft Exposure Draft which proposes amendments to the fee-related provisions of the Code. Technical Staff note the PIOB approval is outstanding in relation to the final text of the IESBA's Fees pronouncement but believes that it is unlikely that there will be substantive amendments.

There are three main elements to the proposed amendments to APES 110, set out below for the Board's consideration.

a) Revisions based upon amendments to the IESBA Code

The proposed Fees Exposure Draft (ED 03/21) includes the following proposed key amendments to the Code to ensure alignment with the revisions to the IESBA Code:

- Requirements and application material to address the issue of threats to independence created when fees are negotiated with and paid by the audit or assurance client. (Sections 410 and 905)
- Clarification that the audit fee should be standalone so that the provision of services other than audit does not influence the level of the audit fee.
- Requirements for the Firm to cease to be the auditor for a Public Interest Entity (PIE) audit client if circumstances of fee dependency continue beyond 5 years.
- A new requirement that introduces a fee dependency threshold for non-PIEs audit clients when total fees from a client is 30% or more of the Firm's total fees for 5 consecutive years.
- New requirements to improve the transparency of 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.
- New guidance to assist firms 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.
- Enhanced guidance material on evaluating the level of threats to the fundamental principles and likely safeguards to address identified threats (Sections 320 & 905).
- An additional example included on the pressure to reduce fees impacting the ability to perform an engagement with professional competence and due care. (Section 270)
- Reference to the system of quality management as a resource to assist in determining whether threats created are at an acceptable level.

In reviewing the IESBA Code amendments, Technical Staff have analysed the recommendations made in APESB's submission to the IESBA Exposure Draft on fees.

Refer to Agenda Item 11(c) for a summary of the APESB recommendations and the IESBA responses.

b) Revisions to address recommendations from the PJC Inquiry(PJC) Inquiry into Audit Regulation in Australia

APESB Technical Staff have considered the recommendations of the PJC Inquiry that are within APESB's remit. We are of the view that the two recommendations that relate to APESB could be addressed through inclusions in the proposed Fees ED. The recommendations and proposed treatment are set out below for the Board's consideration.

Fee Disclosures and non-audit services (Recommendation 3 of PJC Inquiry)

Recommendation 3 of the PJC Inquiry states:

The committee recommends that the Financial Reporting Council, in partnership with ASIC, by the end of the 2020–21 financial year, oversee consultation, development and introduction under Australian standards of:

- *defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and*
- *a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.*

Technical Staff consider that there are two main elements of the first tranche of this recommendation being the auditor remuneration disclosure requirements and the definitions of categories to be included in the disclosure.

The Australian Accounting Standards Board (AASB), in response to PJC recommendation 3, 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. APESB Technical Staff performed technical reviews of this research report before its publication to ensure consistency with the requirements of APES 110. At their Board Meeting on 25 February 2021, the AASB will be considering a project proposal to assess and implement the necessary disclosures to be included in the financial statements for preparers.

APESB Technical Staff believe that the Code should also incorporate guidance on the categories of services and what would be included within each category. This could be a useful guide for auditors to consider how different services affect their independence and compliance with the fundamental principles of the Code.

In considering the categories, Technical Staff believe the following categories are the preferred options to set out disclosures against:

- Audit Services
- Audit-Related Services
- Other Assurance Services
- Tax Services
- Other Services

Technical Staff have been considering defining these categories and believe that the categorisation used in the [FRC UK Ethical Standards 2019](#) could be applied with some modifications in the Australian context.

Refer to Agenda paper 11 (d) for potential options to describe these categories in the Fees ED. Technical Staff are of the view that the best location for these descriptions would be in Sections 410 and 905.

Note that the options for the Fees ED only consider the defined categories of fee disclosures. Refer to agenda paper 10 for proposals to address the second tranche of the PJC recommendation relating to a list of prohibited non-audit services. Also, note the key stakeholder's letter addressing these matters included at Agenda Item 10.

Incentivisation of Audit Partners (Recommendation 5 of the PJC Inquiry)

Recommendation 3 of the PJC Inquiry states:

The committee recommends that the Accounting Professional and Ethical Standards Board consider revising the APES 110 Code of Ethics to include a safeguard that no audit partner can be incentivised, through remuneration advancement or any other means or practice, for selling non-audit services to an audited entity.

The extant Code included a prohibition on audit partners being incentivised for selling non-assurance services to their audit clients. However, this recommendation indicates that this prohibition's scope should be expanded to capture the sale of non-assurance services to all audit clients of the Firm.

While we note the Federal Government has not yet responded to this recommendation, Technical Staff believe this proposed broader prohibition should be included in the Fees ED to consult stakeholders. This amendment is set out in the proposed paragraph AUST 411.4.

Technical Staff seeks the Board's views on the proposed options to address the PJC recommendations in the draft Fees ED.

c) Request 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 the Code in 2013 to address the SMSF sector. APESB has recently received request from the 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 have recommended that a threshold of 20% should be included to provide clarity when a referral source represents a large proportion of fees, particularly in the SMSF sector.

Technical Staff are supportive of including this proposed amendment in the Fees Exposure Draft. The revision would be made in the proposed paragraph AUST R410.3.1 as set out below. For the Board's reference, Technical Staff have also included the related guidance paragraph below.

AUST R410.3.1 When the total fees in respect of multiple **Audit Clients** referred from one source represent ~~a large proportion~~ more than 20% of the total fees of the **Firm** expressing the audit opinions, the **Firm** shall evaluate the significance of the threat and apply safeguards when necessary to eliminate the threat or reduce it to an **Acceptable Level**.

AUST 410.3.1 A1 Another party or Firm may refer multiple Audit Clients to a Firm. The dependence on that source and concern about losing those clients creates a self-interest or intimidation threat. Paragraph 410.3 A2 provides examples of factors that may affect the significance of the threat and paragraph 410.3 A6 lists potential safeguards that may be applied.

This is not a prohibition but recognises that when you exceed the 20% threshold then the Member will need to take action to evaluate the threats to independence and implement appropriate safeguards, if required.

The proposed Fees ED is presented as a marked-up version and a clean version at agenda paper 11 (a) and 11 (b).

Way forward

As noted above, the IESBA is yet to release the final pronouncements in relation to the Fee-related provisions in the International Code. Subject to the Board's views and feedback on the options in this paper, Technical Staff propose the following way forward:

- Review the final IESBA pronouncement in May 2021 for any further revisions to text;
- Develop guidance on fee classifications using the base in the UK Ethical Standard and adding Australian context;
- Present the final proposed Exposure Draft for Board approval out of session in May 2021; and
- Issue the Proposed Fees Exposure Draft ED 03/21 in May 2021 with a 90-day exposure period;

Staff Recommendation

That the Board consider the draft exposure draft which proposes revisions to the fee-related provisions of the Code and provide their views and feedback on the:

- revisions to align with international developments;
- options to address the recommendations from the PJC Inquiry; and
- the request from regulators to include a threshold in the AUST provision relating to multiple audit clients' referral from one source.

Materials Presented

Agenda Item 11(a)	Proposed Fees Exposure Draft ED 03/21 (mark-up)
Agenda Item 11(b)	Proposed Fees Exposure Draft ED 03/21 (clean)
Agenda Item 11(c)	APESB submission – key comments and IESBA responses
Agenda Item 11(d)	Preliminary research on options concerning fee categories.

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