

AGENDA PAPER

Item Number: 1

Date of Meeting: 14 May 2021

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

Action required For discussion For noting For information

Purpose

To obtain the Board's approval:

- (a) Subject to the Board's review comments and editorials, to issue an Exposure Draft on proposed revisions to the fee-related provisions of APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code); and
- (b) of Technical Staff's proposed way forward in relation to the revisions to the Code.

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](#)).

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.

At the March 2021 Board Meeting, the Board considered a preliminary draft of the APESB Exposure Draft proposing amendments to the Code. The preliminary Exposure Draft was based on the final text of the revisions approved by IESBA at their November/December 2020 Board Meeting. The text and final standard were to be considered and approved by the PIOB in April 2021.

On 28 April 2021, the IESBA issued the final pronouncement: *Revisions to the Fee-related Provisions of the Code*. The changes are to the provisions of the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the IESBA Code) and are effective from 15 December 2022.

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. The Board reviewed a preliminary draft of the exposure draft at the March 2021 Board Meeting (refer to [BM 105 agenda item 11\(b\)](#) for the clean version of the draft exposure draft).

Due to the limited changes being presented to the Board in this Board Paper, Technical Staff have not reproduced the complete exposure draft in this agenda paper. Instead, the proposed changes are set out in this agenda paper or in the attached extract (refer to Agenda paper 1(a)).

In relation to the new amendments to the fee-related provisions., the following five matters have been considered by Technical Staff.

a) The IESBA Final Pronouncement versus the IESBA approved text

To facilitate the efficient and timely release of this ED, Technical Staff prepared a preliminary draft of the Exposure Draft based on the final text of the IESBA's Fees Pronouncement. At the time of preparing the draft ED, the approval from the PIOB was outstanding. However, this approval was given on the 28th of April 2021. The IESBA has subsequently released the final pronouncement for Fees.

APESB Technical Staff have reviewed the final pronouncement released by the IESBA and compared it to the final text used as the basis of preparing the preliminary exposure draft. There is only one change to the comma position in paragraph 905.10 A1 that needs to be incorporated into APESB's Fees Exposure Draft. This change ensures the text is consistent with the equivalent paragraph in Section 410 (refer to paragraph 410.14 A1) is marked up below:

Total Fees — Fee Dependency

905.10 A1 When the total fees generated from an **Assurance Client** by the **Firm** expressing the conclusion in an **Assurance Engagement** represent a large proportion of the total fees of that **Firm**, the dependence on, and concern about the potential loss of fees from that client impact the level of the self-interest threat and create an intimidation threat.

b) References to APES 320 and/or quality management standards

When the preliminary draft exposure draft was prepared, the Board had not yet determined the approach to be adopted concerning the revision of APES 320 *Quality Control for Firms* (APES 320) to address the release of the international standards on quality management issued by the International Auditing and Assurance Standards Board (IAASB) in December 2020.

At the March 2021 Board Meeting, the Board agreed to develop APES 320 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 AUASB (based on the IAASB equivalents).

This approach means that, depending on the services provided by the Member, either APES 320 and/or the quality management standards issued by the AUASB may be applicable. Therefore, Technical Staff propose to update the proposed references to quality management standards in the Fees Exposure Draft to incorporate both standards as shown in proposed paragraph 410.4 A4 below:

410.4 A4 The conditions, policies and procedures described in paragraph 120.15 A3 (particularly the existence of a quality management system designed and implemented by the Firm in accordance with ~~{~~APES 320 [Quality Control for Firms](#) ~~}~~ and the ~~/~~quality management standards issued by the AUASB~~}~~) might also impact the evaluation of whether the threats to Independence are at an Acceptable Level.

The reference to APES 320 and the quality management standards also needs to be amended in proposed paragraphs 905.3 A4 and 120.15 A3.

c) Establishing categories for fee disclosures (PJC recommendation 3)

As approved by the Board at the March 2021 Board Meeting, Technical Staff have developed categories of fees in relation to services provided by Members in Public Practice. The focus of the categories is on services provided by the external auditor of the entity, as this was the key area of concern raised in the PJC Inquiry.

In drafting the fee categories, Technical Staff have considered the following:

- The Categories used in other jurisdictions, in particular, the categorisation used in the [FRC UK Ethical Standards 2019](#);
- The views of key stakeholders, outlined in [Research Report 15 – Review of Auditor Remuneration Requirements](#) released by the AASB in February 2021, and the confidential letter provided to the Board as part of the March 2021 board agenda paper 10.

The categories fees are as follows:

- Audit Services
- Audit-Related Services
- Other Assurance Services
- Taxation Services
- Other Services

Refer to Agenda paper 1 (a) for the extract of the Fees exposure draft with the proposed wording relating to these categories within Sections 410.

d) Incentivisation of Audit Partners (PJC recommendation 5)

Technical Staff have considered feedback from the Board and the comments made in the confidential submission by a stakeholder (presented to the Board at BM 105 Agenda Item 10) to develop amendments to the requirement in paragraph AUST R411.4.

Technical Staff have also considered the developments that are occurring in overseas jurisdictions in relation to compensation of audit partners for the sale of non-assurance services. In the UK, the government is in the process of implementing wide reforms to audit providers by requiring the Big 4 firms to operational separate their businesses between audit and all other services.

The UK Government are currently proposing to require:

- the creation of independent Audit Boards within firms to strengthen governance within audit practices;
- Audit Boards to have oversight of audit partner remuneration and ensure it is linked to audit quality;
- the publication of a separate profit and loss account for the audit practice, with cross subsidies between the audit practice and the rest of the firm accounted for through arm's-length transfer pricing; and
- regulatory oversight of the remuneration of audit partners, with a view to supporting policies and practices that reward high-quality audits.

These proposals are currently out for consultation with comments due on 8 July 2021. For the Board's information an extract of the relevant section on audit partner remuneration is included at Agenda Item 1(b). The full consultation paper is available at the [UK Government website](#).

Based on the comments from the confidential stakeholder and considering the proposed strict approach being implemented in some overseas jurisdictions, Technical Staff have drafted the following amendments for the Board's consideration to strengthen the extant prohibition on audit partners being incentivised for selling non-assurance services to their audit clients to capture the sale of non-assurance services to all audit clients of the Firm. Technical Staff are of the view that the preliminary draft paragraph addresses the confidential stakeholder's concerns and note that the exposure draft due process will allow key stakeholders, such as firms, to provide their views and feedback which will further refine this requirement. The Board's feedback is sought on this proposed paragraph.

AUST R411.4 A Firm shall not evaluate or compensate a Key Audit Partner, either directly or indirectly, based on that partner's success in selling non-assurance services to any of the Partner's Audit Clients of the Firm. A Firm shall take reasonable steps to ensure that any profit-sharing arrangement of a Key Audit Partner is not a cross-subsidisation of the Audit Engagement by other service lines of the Firm or a mechanism for distributing indirect incentives to Key Audit Partners based on their ability to sell non-assurance services to the Firm's Audit Clients. This requirement does not preclude normal profit-sharing arrangements between partners of a Firm.

e) Inclusion of a threshold in relation to fee dependency on a referral source of multiple audit clients (SMSF issues)

At the March 2021 Board meeting, the Board agreed to include a threshold in the proposed paragraph AUST R410.3.1 relating to fee dependency on a referral source that refers

multiple audit clients to a firm. The Board also agreed that this threshold should be applied to individual partners of an office within the firm. Technical Staff have updated the proposed drafting of paragraph AUST R410.3.1 and the related guidance paragraph AUST 410.3.1 A1 to include this revision, as set out 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 Engagement Partner, an Office of the Firm or 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 an Engagement Partner, an Office of a Firm or 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.

Technical Staff seeks the Board's views on the proposed drafting revisions to the proposed Fees Exposure Draft to address the five matters noted in this agenda paper.

Way forward

Subject to the Board's approval on the Fees exposure draft, Technical Staff propose the following way forward:

- Issue the Proposed Fees Exposure Draft ED 03/21 in May 2021 with a 90-day exposure period;
- Review and analyse submissions received on ED 03/21 and consider whether any further revisions are required to the Fee-related provisions of the Code;
- Monitor developments relating to the final report of the PJC Inquiry and the Government's response and consider amendments to the Code, if any; and
- Seek approval from the Board to issue an Amending Standard to the Code relating to Fees at the November 2021 Board Meeting.

Staff Recommendations

That the Board approve:

- (a) Subject to the Board's review comments and editorials, the issue of an Exposure Draft on proposed revisions to the fee-related provisions of APES 110 (ED 03/21); and
- (b) The Technical Staff's proposed way forward in relation to the revisions to APES 110.

Materials Presented

Agenda Item 1(a) Extract of proposed amendments to the Draft Fees Exposure Draft for audit fee categories.

Agenda Item 1(b) Extract of UK Government proposals on operational separation for audit firms

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Date: 7 May 2021