

Fee-Related Issues—Planning Committee Recommendations**Background**

1. At the April 2015 IESBA meeting, the Board noted that the PIOB, in communicating its approval of due process for the non-assurance services (NAS) pronouncement, had highlighted the limited scope of the project and urged the Board to revisit issues on auditor independence from a broader perspective, including consideration of fee-related issues.
2. Among possible initial courses of action in response to the PIOB comment, IESBA leadership suggested that the Board could consider commissioning an appropriate staff alert to raise professional accountants' (PAs') awareness of the relevant fee-related issues. Among other matters, IESBA members noted the following:
 - Some concerns with respect to fee-related issues have been heard at the CAG. In addition, some of the fee-related issues may be systemic, for example, the adverse impact of low audit fees on audit quality and firms' ability to attract and retain talent.
 - There are perceptions among some stakeholders regarding downward pressure on audit fees created by mandatory firm rotation and mandatory tendering in some jurisdictions.
 - Some investors and regulators have expressed concerns related to firms' business models, specifically the continuing significant growth in the advisory services arms of the larger firms and the related implications for audit quality and independence.
3. In responding to the Board's most recent strategy review survey and consultation paper, the International Organization of Securities Commissions (IOSCO) had also raised a number of specific concerns on the topic. These concerns are centered on three areas, namely fee dependency issues, fee caps on NAS, and the impact of low audit fees on audit quality. For information, IOSCO's detailed comments are set out in Appendix 1.
4. At the May 2015 IESBA-National Standard Setters (NSS) meeting, IESBA leadership shared the PIOB's comment with NSS participants and invited them to let the Board know of any national initiatives, including fact-finding or research, they may have undertaken in that regard. To date, no responses have been received from the NSS.
5. In early June 2015, IESBA leadership discussed the fee-related topic with a group of Technical Advisors (TAs) supporting IESBA members to explore how the TAs could assist the Board in fact-finding and research. A number of the TAs expressed willingness to participate in a working group to assist the Board in this regard.
6. During the discussion with the TAs, it was noted that the American Institute of Certified Public Accountants (AICPA) has issued a non-authoritative frequently-asked question (FAQ) to address the issue of low audit fees, and that this guidance has approached the issue more from the perspective of due care than independence.

Planning Committee Recommendations

A. Timing of Research

7. Given the above developments, the Planning Committee is of the view that the Board should endeavor to respond to the PIOB's comment. Some of the fee-related issues, in particular fee dependency, NAS fee caps and business models, are potentially complex and will require research. The Board had already committed to doing so in its Strategy and Work Plan, 2014-2018, starting from mid-2017.
8. However, as a number of TAs have agreed to participate in a WG to assist the Board in the research effort, the Planning Committee did not see reason to defer the start of this effort to mid-2017. Accordingly, the Planning Committee recommends that the Board approve the formation of a working group to initiate the research to establish a basis for defining the nature and scope of the issues to be addressed.
9. In this regard, IESBA leadership proposes that the working group be led by an IESBA member and include four TAs.

Matter for Consideration

1. The Board is asked whether it agrees with the Planning Committee's recommendation.

B. Proposal for an IESBA Staff Alert

10. The Planning Committee recommends that with respect to the issue of low audit fees and market pressure on audit fees, the Board commission a staff alert to raise auditors' awareness of this issue. Such an action, which would not call for a significant commitment of resources, would have the benefit of providing a timely Board response to some of the concerns that the PIOB and some regulatory and other stakeholders have raised. If developed, such a publication could be disseminated by firms to their audit personnel. It could also be used or adapted by NSS to further raise awareness of the issue at the national level.
11. The Board has not previously commissioned staff alerts. The International Auditing and Assurance Standards Board (IAASB), however, has commissioned several of these publications in the past to raise auditors' awareness of specific practice issues.

Nature of a Staff Alert

12. An IESBA staff alert would be a publication prepared and issued by IESBA staff to highlight one or more significant emerging ethics or ethics-related issues in a timely manner. An awareness of these issues may assist auditors and other PAs in more effectively fulfilling their obligations to comply with the Code's fundamental principles.
13. Matters that would lend themselves to staff alerts include those in respect of which it would be helpful to:
 - Raise PAs' awareness of, or direct their attention to, the relevant provisions of the Code that may apply in the particular circumstances.
 - Reinforce key messages concerning the principles in the Code.

- Clarify or facilitate PAs' understanding of the relevant provisions of the Code.
14. Staff alerts would not be appropriate for complex or highly judgmental matters that would require interpretation of specific provisions of the Code, or that would call for research and careful study leading potentially to modification of, or addition to, the Code.
 15. A staff alert does not override the Code. It would be a non-authoritative document issued for information purposes only and would not be subject to the Board's due process. The Board may, however, advise staff on the development of the publication.
 16. For information, the IAASB's *process* for developing a staff publication is set out in Appendix 2.

Working Group and Timing

17. Subject to the Board's agreement to commission this publication, the Planning Committee proposes that a small working group comprising 2-3 IESBA members be set up to advise staff on the development of the alert.
18. Possible timing for the initiative could be as follows:
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| • Board commissioning of alert | June/July 2015 IESBA meeting |
| • Draft alert to Board for comment | 2 nd – 3 rd week of August 2015 |
| • Report-back on disposition of Board comments | September 2015 IESBA meeting |
| • Issuance of final publication | Early October 2015 |

Key Considerations and Messages

19. Prior to developing the alert, staff will consider any relevant publications NSS, the academic community and others may have issued on the topic of low audit fees/undue fee pressure.
20. Subject to the above, a tentative outline of the proposed alert is as follows:

- Introduction
 - Purpose of the alert, reminding auditors of their responsibilities under the Code
 - Topics discussed in the alert
 - Caveats
- Background
 - Developments in the environment that are creating downward pressure on audit fees, including competitive pressure and pressure from clients
 - Other circumstances that may give rise to pressure on audit fees (e.g., concern about the possibility of losing a significant client, or threat of dismissal by a client)¹
 - Nature of concerns raised by the regulatory community and other stakeholders
 - Relevant empirical evidence

¹ Section 200, *Introduction*, paragraphs 4 and 8

- Role of those charged with governance in approving audit fees and assessing audit quality in some jurisdictions
- Acknowledgement that component fees may be set at the group engagement level in a group audit
- No IESBA presumption that firms are not delivering high quality audits when audit fees are low
- Auditor's responsibilities under the Code
 - Obligation to comply with the fundamental principles
 - Importance of complying with professional standards regardless of the fee level
- Potential threats created by low audit fees/undue fee pressure
 - Warning from the Code regarding threats to compliance with the fundamental principles that may arise from the level of fees quoted²
 - Types of threats that may be created and fundamental principles in respect of which compliance may be threatened (e.g., intimidation threat to due care as a result of client pressure to inappropriately reduce extent of work performed)³
 - Examples of practical consequences caused by low audit fees that may give rise to such threats, e.g., use of less experienced engagement team members when more experienced individuals would be warranted; reduced level of professional skepticism
- Relevant factors to consider in evaluating the significance of the threats, e.g.:
 - Level of fee quoted and nature of service⁴
 - Professional standards, which dictate the nature and extent of work required
 - Nature and extent of regulatory monitoring
- Key message
 - All audits must be performed to a high quality in full compliance with professional standards regardless of the audit fee level
- Raise awareness about broader considerations concerning the impact of low audit fees on audit quality, e.g.:
 - Potential for commercial considerations to override audit quality
 - Ability of firms to attract and retain high quality audit professionals
 - Ability to invest in tools and resources to deliver high quality audits
- Importance of considering any specific national guidance that may exist

² Section 240, *Fees and Other Types of Remuneration*, paragraph 1

³ Paragraph 200.8

⁴ Paragraph 240.2

Matters for Consideration

2. The Board is asked whether it agrees with the Planning Committee's recommendation to commission a staff alert on the topic of low audit fees/undue fee pressure.
3. If so, the Board is asked for views on the outline of the proposed alert.

Appendix 1

Comments from IOSCO

1. Extract from May 2013 IOSCO Response to IESBA Strategy Review Survey

Fee dependence

The safeguards for fee dependency do not appear to be commensurate with the potential threats to independence that the Code seeks to prevent. In particular, the Code should:

- (a) Outline circumstances where the auditor is required to decline an engagement as a safeguard to eliminate any self interest or intimidation threat that may arise from significant fee dependency. Paragraphs 290.221 to 290.223 do not require an auditor to decline an engagement;
- (b) Require an external review from the outset, not just in the second or subsequent year audits. The requirement for an Engagement Quality Control Review to be performed on a listed engagement prior to the issuance of an audit opinion is an existing requirement of the auditing standards and does not provide any additional safeguard against fee dependency for public interest entities;
- (c) Require pre-issuance reviews in all instances as post-issuance reviews are a detective measure rather than a preventative measure; and
- (d) Include quantitative guidance as to the level of acceptable fees for non-public interest entities.

In addition, the level of non-audit services provided to audit clients may threaten independence but this is not considered in the Code. The Code should include guidance in relation to when the quantum of non-audit services may threaten independence.

2. Extract from March 2014 IOSCO Response to IESBA SWP 2014-2018 Consultation Paper

Undue Fee Pressure

We believe Section 240 of the Code (namely, Fees and Other Types of Remuneration) does not adequately address the threats and safeguards regarding setting audit fees for the engagement and the potential effect of the fee level on the quality of the audit. Audit firms competing for an audit engagement by using low fees in an attempt to obtain the audit client can have a negative impact on audit quality if that fee level translates into inadequate audit work. As such, the Board should determine the most effective manner for the Code to address the threats and safeguards associated with the negative incentives to carry out inadequate audit procedures as a result of audit fee pressures.

Appendix 2

IAASB Process for Developing a Staff Publication

1. The IAASB is responsible for commissioning a staff publication.
2. In commissioning a staff publication, the IAASB advises staff on matters relevant to the development of the publication. This may include instructing staff on matters which would not be appropriate for inclusion in the publication.
3. For each publication, the IAASB Chair, in consultation with the IAASB Steering Committee and IAASB Technical Director, appoints a small group of IAASB members, and others as appropriate, to advise staff on the development of the publication. This advisory group provides input on technical and drafting matters, and reviews the general quality of the draft publication.
4. Before a staff publication is issued, all IAASB members are provided an opportunity to consider and comment on whether it is consistent with, and does not extend beyond, the authoritative pronouncement to which it relates.
5. Staff, in consultation with the appointed advisory group, is responsible for addressing any substantive concern raised by IAASB members. All IAASB members are then provided an opportunity to consider and comment on how these concerns have been addressed by staff.
6. The IAASB Technical Director, in consultation with the IAASB Chair, is responsible for approving release of a staff publication. Staff publications are made available only on the IAASB's website.