

Preliminary Draft of Proposed Changes to the Code

This document illustrates how the Task Force's proposals summarized in **Agenda 6-A** would impact the Code and includes suggested revisions to:

- (a) Sections 330 and 410 to strengthen the fee provisions in the Code in the context of audit and review engagements (Sections A and B of this document).
- (b) Sections 270 to enhance the provisions in the Code for PAIBs who have a role setting fees in Section (Section C of this document).
- (c) Sections 320 and Section 400 to clarify certain provisions that will assist firms apply the fee provisions in the Code (Section D of this document).

During the meeting, Board members will be asked to consider and provide their views on the Task Force's proposals. Detailed drafting suggestions are welcome via email. Please email them to SzilviaSramko@ethicsboard.org.

Section A – Proposed Revisions to Section 330

SECTION 330

FEES AND OTHER TYPE OF RENUMERATION

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Application Material

Level of Fees

- 330.3 A1 The level of fees quoted might impact a professional accountant's ability to perform professional services in accordance with professional standards.
- 330.3 A2 A professional accountant might quote whatever fee is considered appropriate. Quoting a fee lower than another accountant is not in itself unethical. However, the level of fees quoted creates a self-interest threat to compliance with the principle of professional competence and due care if the fee quoted is so low that it might be difficult to perform the engagement in accordance with applicable technical and professional standards.
- 330.3 A3 Factors that are relevant in evaluating the level of such a threat include:
- Whether the client is aware of the terms of the engagement and, in particular, the basis on which fees are charged and which professional services the quoted fee covers.
 - Whether the level of the fee is set by an independent third party such as a regulatory body.
- 330.3 A4 Examples of actions that might be safeguards to address such a self-interest threat include:
- Adjusting the level of fees or the scope of the engagement.
 - Having an appropriate reviewer review the work performed.
- 330.3 A5 Requirements and application material related to the level of fees for audit and review engagements are set out in the International Independence Standards.

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Section B – Proposed Revisions to Section 410

PART 4A – INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

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SECTION 410

FEES

Introduction

- 410.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.
- 410.2 The nature and level of fees or other types of remuneration might create a self-interest or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Fees – Level of Fees

R410.3 A firm shall be satisfied that the fees quoted for an engagement shall not affect the firm's ability to perform the audit in accordance with professional standards.

R410.4 The engagement partner shall determine whether sufficient and appropriate resources are assigned or made available to perform the engagement, irrespective of the fees quoted.

Communication to Those Charged with Governance

R410.5 A firm shall communicate its compliance with paragraph R410.3 to those charged with governance.

410.5 A1 The requirements and application materials in paragraph R300.10 to 300.10 A1 apply when determining the appropriate individuals within the entity to whom the firm communicates.

Public Disclosure of Audit Fees

410.6 A1 As an exception to paragraph 400.2, the requirements and application material relating to public disclosure of audit fees do not apply to engagements for the audit of special purpose financial statement and to review engagements.

R410.7 A firm shall consider the laws and regulations governing the audit client's public disclosure of audit fees, and determine if the audit client is in compliance.

Audit Clients that are Not Public Interest Entities

410.8 A1 If not otherwise publically available, the firm is encouraged to disclose publically the audit fee for audit clients unless such disclosure is prohibited by laws or regulations.

Audit Clients that are Public Interest Entities

R410.9 If not otherwise publically available, the firm shall disclose publically the audit fee for audit clients that are public interest entities unless such disclosure is prohibited by laws or regulations.

410.9 A1 The disclosed audit fee should reflect the fee paid or estimated to be payable based on the information available at the time of the disclosure.

410.9 A2 In relation to the audit of group accounts the required disclosure is the aggregate of the audit fees received for all the components relevant to that group audit.

R410.10 The firm shall disclose the information within a reasonable time after the issuance of the audit report and in an accessible manner.

410.10 A1 A reasonable time would generally be within a month after the audit report is issued.

410.10 A2 Examples of ways such disclosure may be made by the firm include:

- Disclosure in the auditor's report, or
- Disclosure on the public website of the firm.

Fees – Relative Size of Audit Fees

All Audit Clients

410.~~113~~ A1 When the total fees generated from an audit client by the firm expressing the audit opinion represent a large proportion of the total fees of that firm, the dependence on that client and concern about losing the client create a self-interest or intimidation threat.

410.~~113~~ A2 Factors that are relevant in evaluating the level of such threats include:

- The operating structure of the firm.
- Whether the firm is well established or new.
- The significance of the client qualitatively and/or quantitatively to the firm.

410.~~113~~ A3 An example of an action that might be a safeguard to address such a self-interest or intimidation threat is increasing the client base in the firm to reduce dependence on the audit client.

410.~~113~~ A4 A self-interest or intimidation threat is also created when the fees generated by a firm from an audit client represent a large proportion of the revenue of one partner or one office of the firm.

410.~~113~~ A5 Factors that are relevant in evaluating the level of such threats include:

- The significance of the client qualitatively and/or quantitatively to the partner or office.
- The extent to which the compensation of the partner, or the partners in the office, is dependent upon the fees generated from the client.

410.~~113~~ A6 Examples of actions that might be safeguards to address such self-interest or intimidation threats include:

- Increasing the client base of the partner or the office to reduce dependence on the audit client.
- Having an appropriate reviewer who did not take part in the audit engagement review the work.

Audit Clients that are Not Public Interest Entities

[R] 410.12 When total fees from the audit client represent more than 30% of the total fees received by the firm expressing the opinion on the financial statements of the client, after the first year of the engagement, and then each year for the next [two] four years, the firm [shall] [is encouraged] to:

- (a) Disclose to those charged with governance of the audit client the fact that the total of such fees represents more than 30 % of the total fees received by the firm, and

[(b) Discuss with those charged with governance whether that fact should be made public.]

R410.13 If the fees described in paragraph [R] 410.12 continue to exceed 30 % for [three] [five] consecutive years the firm shall:

[(a) Disclose to those charged with governance of the audit client the fact that the total of such fees represents more than 30 % of the total fees received by the firm; and]

(b) Discuss with those charged with governance of the audit client whether either of the following actions might be a safeguard to address the threat created by the total fees received by the firm from the client, and if so, apply it:

(i) Prior to the audit opinion being issued on the [third] [fifth] year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, performs an engagement quality control review of that engagement; or a professional body performs a review of that engagement that is equivalent to an engagement quality control review ("a pre-issuance review"); or

(ii) After the audit opinion on the [third] fifth year's financial statements has been issued, and before the audit opinion being issued on the [fourth] [sixth] year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, or a professional body performs a review of the second year's audit that is equivalent to an engagement quality control review ("a post-issuance review").

410.13 A1 The requirements and application materials in paragraph R300.10 to 300.10 A1 apply when determining the appropriate individuals within the entity to whom the firm disclose the information.

R410.14 If the fees described in paragraph R410.13 continue to exceed 30%, the firm shall each year:

(a) Disclose to and discuss with those charged with governance the matters set out in paragraph R410.13; and

(b) Comply with paragraphs R410.13 (b).

Audit Clients that are Public Interest Entities

[R] 410.15 Where an audit client is a public interest entity and the total fees from the client and its related entities represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, after the first year of the engagement, the firm [shall] [is encouraged] to:

(a) Disclose to those charged with governance of the audit client the fact that the total of such fees represents more than 15 % of the total fees received by the firm, and

(b) Discuss with those charged with governance whether that fact should be made public.

R410.164 Where an audit client is a public interest entity and, for two consecutive years, the total fees from the client and its related entities represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, the firm shall: If the fees described in paragraph 410.15 continue to exceed 15 % for two consecutive years, the firm shall:

(a) Disclose to those charged with governance of the audit client **and publically** the fact that the total of such fees represents more than 15% of the total fees received by the firm; and

(b) Discuss whether either of the following actions might be a safeguard to address the threat created by the total fees received by the firm from the client, and if so, apply **and disclose it publically**:

- (i) Prior to the audit opinion being issued on the second year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, performs an engagement quality control review of that engagement; or a professional body performs a review of that engagement that is equivalent to an engagement quality control review ("a pre-issuance review"); or
- (ii) After the audit opinion on the second year's financial statements has been issued, and before the audit opinion being issued on the third year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, or a professional body performs a review of the second year's audit that is equivalent to an engagement quality control review ("a post-issuance review").

R410.175 When the total fees described in paragraph R410.154 significantly exceed 15%, ~~the firm shall determine whether the level of the threat is such that a post-issuance review would not reduce the threat to an acceptable level. If so, the firm shall have a pre-issuance review performed.~~

- (a) Disclose to those charged with governance of the audit client and publically the proportion of fees generated from the audit client to total fees received by the firm; and
- (b) Discuss with those charged with governance whether a pre-issuance review set out in paragraph R410.15 (b) might be a safeguard to address the threat created by the total fees received by the firm from the client, and if so, apply it.

R410.17 A1 Total fees described in paragraph R410.15 significantly exceed 15 % if the firm determines that the same conclusion would be likely be reached by a reasonable and informed third party, however in any case if they exceed 30 %.

R410.186 If the fees described in paragraph R410.416 continue to exceed 15%, the firm shall each year, for the next two years:

- (a) Disclose to and discuss with those charged with governance the matters set out in paragraph R410.16; and
- (b) Comply with paragraphs R410.416(b) and R410.517.

R410. 19 If the fees described in paragraph R410.15 continue to exceed 15 % for five consecutive years, the firm shall cease to be the auditor after the audit report is issued.

410.20 A1 The requirements and application materials in paragraph R300.10 to 300.10 A1 apply when determining the appropriate individuals within the entity with whom the firm communicates when disclosure to those charged with governance is required in this subsection (Fees- Relative Size).

410.20 A2 The requirements and application material in paragraph R410.10 to 410.10 A2 apply when public disclosure is required in this subsection (Fees- Relative Size).

Fees –Ratio of Fees for Audit and Services Other than Audit [See Agenda Item 7]

Audit Clients that are Public Interest Entities

R410.21 When a firm provides services other than audit to an audit client that is a public interest entity, and for three consecutive years the total fees the services other than for the audit engagement received from that audit client and its related entities reaches the 70% of the average of the last three years fees for the audit, the firm shall:

- (a) Disclose to those charged with governance and publicly the fact that total fees of the services other than audit from an audit client has reached 70% of the average of the last three years fees received from that audit client for audit; and

(b) Discuss whether either of the following actions might be a safeguard to address the threat created by the total fees of the services other than audit from an audit client reach 70% of the average of the last three years fees received from that audit client for audit, and if so, apply it:

(i) Prior to the audit opinion being issued on the third's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, performs an engagement quality control review of that engagement; or a professional body performs a review of that engagement that is equivalent to an engagement quality control review ("a pre-issuance review"); or

(ii) After the audit opinion on the third year's financial statements has been issued, and before the audit opinion being issued on the fourth year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, or a professional body performs a review of the second year's audit that is equivalent to an engagement quality control review ("a post-issuance review").

Section C – Proposed Revisions to Section 270

SECTION 270

PRESSURE TO BREACH THE FUNDAMENTAL PRINCIPLES

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Requirements and Application Material

General

R270.3 A professional accountant shall not:

- (a)** Allow pressure from others to result in a breach of compliance with the fundamental principles; or
- (b)** Place pressure on others that the accountant knows, or has reason to believe, would result in the other individuals breaching the fundamental principles.

270.3 A1 A professional accountant might face pressure that creates threats to compliance with the fundamental principles, for example an intimidation threat, when undertaking a professional activity. Pressure might be explicit or implicit and might come from:

- Within the employing organization, for example, from a colleague or superior.
- An external individual or organization such as a vendor, customer or lender.
- Internal or external targets and expectations.

270.3 A2 Examples of pressure exerted on a professional accountant from others that might result in threats to compliance with the fundamental principles include:

- Pressure related to conflicts of interest:
 - Pressure from a family member bidding to act as a vendor to the professional accountant's employing organization to select the family member over another prospective vendor.

See also Section 210, *Conflicts of Interest*.

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- Pressure related to non-compliance with laws and regulations:
 - Pressure to structure a transaction to evade tax.

See also Section 260, *Responding to Non-compliance with Laws and Regulations*.

270.3 A3 An example of pressure exerted by a professional accountant on others that might result in threats to compliance with the fundamental principles would be pressure exerted on another professional accountant to provide professional services at a fee level that did not allow for sufficient and appropriate resources to perform the services.

Section D – Proposed Revisions to Sections 320 and 400

SECTION 320

PROFESSIONAL APPOINTMENT

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Requirements and Application Material

Client and Engagement Acceptance

General

320.3 A1 Threats to compliance with the principles of integrity or professional behavior might be created, for example, from questionable issues associated with the client (its owners, management or activities). Issues that, if known, might create such a threat include client involvement in illegal activities, dishonesty, questionable financial reporting practices or other unethical behavior.

320.3 A2 ...

320.3 A3 A self-interest threat to compliance with the principle of professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies to perform the professional services.

320.3 A4 Factors that are relevant in evaluating the level of such a threat include:

- An appropriate understanding of:
 - The nature of the client's business;
 - The complexity of its operations;
 - The requirements of the engagement; and
 - The purpose, nature and scope of the work to be performed.
- Knowledge of relevant industries or subject matter.
- Experience with relevant regulatory or reporting requirements.
- The existence of quality control policies and procedures designed to provide reasonable assurance that engagements are accepted only when they can be performed competently.
- A level of fees that allows for sufficient and appropriate resources (including human, technological and intellectual property resources) to perform the engagement.

320.3 A5 Examples of actions that might be safeguards...

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SECTION 400

APPLYING THE CONCEPTUAL FRAMEWORK TO INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

Introduction

General

400.1 It is in the public interest and required by the Code that professional accountants in public

practice be independent when performing audit or review engagements.

400.2

This Part applies to both audit and review engagements unless otherwise stated. The terms “audit,” “audit team,” “audit engagement,” “audit client,” and “audit report” apply equally to review, review team, review engagement, review client, and review engagement report.