APESB
Accounting Professional & Ethical Standards Board

**AGENDA PAPER**

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| **Item Number:** | 10 |
| **Date of Meeting:** | 10 March 2022 |
| **Subject:** | Project update: Proposed revision to APES 110 for Fee-related provisions of the Code. |

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| X | **Action required** | X | **For discussion** | X | **For noting** | | **For information** |

## Purpose

To obtain the Board's:

(a) views on the suggested revisions to the proposed amendments in ED 03/21 *Proposed amendments to Fee-related provisions of APES 110 Code of Ethics for Professional Accountants (including Independence Standards)* (ED 03/21);

(b) approval on the revisions to the fee-related provisions of the Code based on:

  (i) the IESBA final pronouncement: Revisions to Fee-related provisions of the Code;

  (ii) references to APES 320 and quality management standards; and

  (iii) the PJC Inquiry recommendation on audit partner incentivisation;

(c) approval to defer the inclusion of audit fee categories in the Code to align with the project being undertaken by the Australian Accounting Standards Board (AASB); and

(d) approval to re-expose revised provisions for fee dependency on a referral source for 30 days.

## 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, a Parliamentary Joint Committee (PJC) Inquiry commenced considering audit regulation in Australia. The PJC held public hearings in 2019 and 2020 and 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.

At the May 2021 Board meeting, the Board approved the issue of Exposure Draft (ED) 03/21 *Proposed Amendments to Fee-related provisions of APES 110 Code of Ethics for Professional Accountants (including Independence Standards)*. The ED was released on 28 May 2021 and the comment period for the exposure draft closed on 31 August 2021.

At the November 2021 Board meeting, the Board received an update on the review of the submissions received in response to ED 03/21 and the key issues that were raised. APESB received 19 submissions from a broad range of respondents, including small-to-medium-practices (SMPs), mid-to-large accounting firms, professional organisations and regulators.

## Key Considerations

To facilitate the consideration of the proposed amendments to the fee-related provisions of the Code, the discussion below is structured based on the driver for change of the proposed amendments (i.e., IESBA Code, recommendations from the PJC Inquiry or regulator's requests). The analysis of the concerns raised by stakeholders, as set out in the general comments table, the specific comments table and the regulators' comments tables at agenda item 10 (b), (d) and (f), respectively, are also considered via the underlying driver for change.

As limited changes are being proposed to the Fees Amending Standard, Technical Staff have not replicated the full version of the Standard in this agenda paper. However, any changes being suggested by Technical Staff are set out below.

### a) The IESBA Final Pronouncement: Revisions to the Fee-related provisions of the Code

The majority of the proposed revisions to the Code are based on the IESBA's final pronouncement on fees, with minor editorial amendments (which were approved by the Board at the May 2021 Board Meeting for inclusion in the exposure draft). The exposure draft also sought specific comments on the intent of application material in proposed paragraph 410.3 A3 in relation to what is included in the term audit fee is clear to stakeholders.

Respondents were generally supportive of the proposed revisions based on the IESBA pronouncements. The concerns raised concerning IESBA based proposals included:

- The arbitrary nature of the thresholds used for the fee dependency provisions on a single audit client for both public interest entity (PIE) and non-PIE audit clients (refer to specific comment items 41 and 42).

- Whether it is appropriate for the auditor to be responsible for disclosing audit fees paid by a client, as per proposed paragraph R410.31 (refer to specific comment items 54 and 55) or notifying the client that there is a fee dependency issue as per proposed paragraph R410.29 (refer to specific comment item 43)
- the use of the word 'may' in requirement paragraphs (refer to specific comment item 7)

Technical Staff note the concerns raised but are of the view that the international base provisions noted above should be adopted without any amendments for the Australian environment.

In relation to the request for specific comment, respondents had mixed views on the clarity of the application material in paragraph 410.3 A3 (refer to specific comment items 1-6).

The IESBA recently released *IESBA Staff Questions & Answers on Revised Fee-related Provisions of the Code,* which confirms the distinction was deliberate. It acts to limit the requirements around communicating with those charged with governance (para R410.23) or disclosing audit fees to the public (para R410.31) to those audits of financial statements for public interest entities (PIEs).

In Australia, there are requirements in the *Corporations Act 2001* (e.g., s302 and 309) for specific entities to prepare a half-year report that must be audited or reviewed. As such, these review engagements are often considered fees for the audit function of the financial statements. Although, a firm may also perform other unlegislated review engagements for a client.

To explain this difference for the Australian environment, APESB Staff propose to include a footnote to para 410.3 A3 which is set out below:

*410.3 A3 For the purposes of this section, audit fees comprise fees or other types of remuneration for an audit or review of Financial Statements. Where reference is made to the fee for the audit of the Financial Statements, this does not include any fee for an audit of Special Purpose Financial Statements or a review of Financial Statements. (Ref: Para. R410.23(a), 410.25 A1 and R410.31(a))*

*Footnote 1: In Australia, there are requirements in the Corporations Act 2001 (for example, in sections 302 and 309) for specific entities to prepare a half-year report which needs to be audited or reviewed. Where a review is performed to meet financial reporting requirements of the Corporations Act 2001, the review is to be considered as a fee for the audit of the Financial Statements of the entity or group.*

Technical Staff seek the Board views on the proposed inclusion of a footnote to paragraph 410.3 A3 and the Board's approval of the revisions to the Code based on the IESBA pronouncement on fees.

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

ED 03/21 proposed amendments to update extant references in the Code to refer to APES 320 Quality Control for Firms (APES 320) and the quality management standards issued by the AUASB (based on the IAASB equivalents) in paragraphs 410.4 A4, 905.3 A4 and 120.15 A3. No objections were raised in the exposure draft due process on this proposed change.

After the release of ED 03/21, the Board has completed a project on revising APES 320. As part of the revision, the title of APES 320 has changed from '*Quality Control for Firms*' to '*Quality Management for Firms that Provide Non-Assurance Services*'. Technical Staff are of the view this change should be reflected in the final Amending Standard issued by APESB, as both the revised APES 320 and the Fees Amending Standard are to become effective at the same time.

Technical Staff, therefore, seek the Board approval to update the name of APES 320 in paragraphs 410.4 A4, 905.3 A4 and 120.15 A3 within the final Amending Standard.

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

In 2020, the FRC established a working group to address the recommendations raised as part of the PJC Inquiry into the Regulation of Auditing in Australia. The Australian Accounting Standards Board (AASB), AUASB, and APESB are part of this working group. The disclosure of the different fee categories was discussed at these meetings. As a result, it was determined that the AASB would establish disclosure requirements for the accounting standards for the entity or preparers and APESB will develop guidance for auditors.

As such, ED 03/21 included a proposed paragraph that set out categories of fees in relation to services provided by Members in Public Practice, particularly services provided by the external auditor of the entity.

Respondents were generally supportive of the proposed categories of services but were concerned that the proposed revisions to include fee categories in the Code would place the requirement to disclosure fees on the auditors rather than on Those Charged with Governance of the entity. Several respondents also suggested that APESB should work with the AASB to ensure the fee disclosures are set out in the accounting standards. The full comments by respondents are set out at items 16 and 17 of the general comments table and items 44 – 53 of the specific comments table.

APESB Technical Staff have been liaising with the AASB Technical Staff about each Board's project on audit fee disclosures. As the AASB are still working on their project, APESB Technical Staff believe that the inclusion of the proposed categories (in proposed paragraph AUST 410.29.1 A1) should be deferred, allowing the AASB to progress their project and to ensure both projects have consistent outcomes.

Technical Staff are aware that several Amending Standards to the Code will be released in the next 12 to 18 months (due to current projects on non-assurance services and the definition of listed entity and public interest entity), which will provide the opportunity to include the fee categories as part of a future Amending Standard.

Technical Staff seek the Board's approval to defer the inclusion of audit fee categories in the Code to align with the timing of the AASB project. APESB Technical Staff will continue to work with the AASB's Technical Staff to ensure consistency with the fee categories to be included in the accounting standards and the Code.

**d) Incentivisation of Audit Partners (PJC recommendation 5)**

A recommendation from the PJC Inquiry into the regulation of auditing in Australia was that the Code of Ethics should be revised 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.

In developing the proposed revisions to the Code for this recommendation, APESB Technical Staff engaged with local stakeholders and also considered the proposed strict approach in some overseas jurisdictions involving operational separation of audit practices.

As a result, proposed paragraph R411.4 was included in the ED 03/21 to seek key stakeholders' views and feedback on whether these proposals would be able to be implemented by firms.

Only four comments were received in the submissions relating to the proposed paragraph on audit partner incentivisation (refer to items 56 - 59 in the specific comments table). Respondents generally supported the proposal to strengthen the audit partner incentivisation requirement. However, it was suggested that further clarity is required on the concept of indirect incentives (and whether this provision impacts a partners' responsibilities to their firm), the term 'reasonable steps' and what is an appropriate profit-sharing model.

Technical Staff believe that it is not practicable to specify profit-sharing models in the Code or to set out what actions should be taken by a firm to meet this requirement. Instead, members should use their professional judgement to determine if their firm's profit-sharing models meet the intent of this requirement.

Based on the comments received, Technical Staff are of the view that the revised requirement should be updated in the Code as proposed in ED 03/21.

<u>AUST R411.4</u>

*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 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 services 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.*

Technical Staff seek the Board's approval of the revised paragraph R411.4 on audit partner incentivisation.

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

After receiving a request from regulators, the Board agreed to include in ED 03/21 a proposal to introduce a 20% threshold (rather than using the term 'a large proportion') to assess fee dependency from a referral source at a firm, an office or a partner level.

This issue was the most commented on matter in the exposure draft, with comments being raised in 15 of the 19 submissions received (refer to items 9 to 40 of the specific comments table).

The respondents' views 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. The concerns included:

- The 20% percentage level specified for the threshold and whether a 30% threshold would be more appropriate.
- How the requirement should be implemented in practice.
- The impact on SMPs, especially sole practitioners, and whether this requirement is too onerous or will cause hardship.
- The lack of a specific time frame for dependency or guidance on the timing of the review.
- The need for additional guidance on what is a referral source and how long that consideration stays in place.
- The need for additional guidance on the role of an appropriate reviewer and who can undertake that role.

In light of the broad range of concerns raised by SMSF audit practitioners, APESB Technical Staff have been engaging with stakeholders on the proposed amendments to the fee dependency threshold for a referral source. An update on stakeholder engagement that occurred up to November 2021 was presented to the Board at the November 2021 Board Meeting.

APESB Technical Staff met with the regulators, ATO and ASIC, on 24 February 2022 to discuss the concerns raised in the submissions. Based on this discussion, Technical Staff drafted revised provisions relating to fee dependency on one referral source, which included:

- An increase of the proposed threshold to 30% (up from 20%);
- The factor of a five-year cumulative time period to be met before the requirement is to be applied;
- The firm must take a definitive action (i.e., a compliance engagement) at the five-year mark; and
- An additional requirement to clarify the position of fee dependency past the initial five-year cumulative period.

The drafting of the revised revisions was based on the IESBA provisions for fee dependency concerns for a single non-PIE audit client (proposed paragraphs R410.15 and R410.16). This ensures that the threats associated with fee dependency are treated consistently, whether the dependency is from one referral source or one audit client. Note that Technical Staff are of the view that due to the limited number of persons able to be connected to a Self-Managed Superannuation Fund (SMSF), it is very unlikely that an SMSF would be considered a PIE.

The draft revised provisions have been sent to the regulators, requesting them to provide feedback by 8 March 2022. Technical Staff will give an oral update on the regulators' feedback at the Board Meeting on 10 March 2022.

Technical Staff met separately with the professional bodies on 3 March 2022 to discuss the draft revised provisions. One professional body raised concerns on the preliminary draft about:

- The type of reviewer that was specified depending on whether the independence assessment is of a partner, an office, or the firm (e.g., the firm should be external, office and partner could be a Member not involved with the Audit Engagement).
- Whether the provisions should refer specifically to compliance engagements or whether it should just say review by an appropriate reviewer (in line with the proposed safeguards in paragraphs 410.14 A4 and 410.14 A7).
- Whether it was necessary to provide guidance on the documentation of the independence assessment.

Technical Staff are also planning to discuss the proposed revisions with the SMSF Association and a group of SMSF auditors on 7 and 8 March 2022. Both stakeholders engaged with APESB Technical Staff in 2021 on the proposals in the initial exposure draft. Technical Staff will provide an oral update on the discussions from these meetings at the Board Meeting on 10 March 2022.

Based on the feedback received to date, Technical Staff have revised the preliminary draft of the referral source fee dependency provisions (refer to Agenda Item 10 (a)) except for the requirement to complete a compliance engagement. Technical Staff believe further consideration needs to be given to what specified action should be undertaken if fee dependency is in place for five consecutive years.

Technical Staff have identified three potential options for actions that could be undertaken:

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

Technical Staff are trying to balance the need to clarify what a review entails (which was raised by SMP practitioners in their submissions) without imposing a significant compliance burden. The action to be undertaken should be the equivalent of conducting either a post or pre-issuance review of financial statements, which occurs when there is a fee dependency on a single non-PIE audit client (as per proposed paragraph R410.15).

Therefore, Technical Staff seeks the Board’s views on the proposed drafting revisions to the referral source fee dependency provisions, including the options identified above.

Due to the significant change to these provisions, Technical Staff recommend that the Board re-expose the referral source fee dependency provisions for a 30 day comment period to determine stakeholder views. However, Technical Staff do not believe re-exposure is necessary for the other proposed revisions in the draft Amending Standard.

## Way Forward

Subject to the Board's decisions at the March 2022 Board Meeting, Technical Staff propose to re-exposure the referral source fee dependency provisions with a 30 day comment period. The outcomes of the due process will be considered by Technical Staff and presented to the Board for their consideration and approval at a future Board Meeting.

Once the last component of the amending standard (i.e., the referral source fee dependency provisions) is approved by the Board, Technical Staff will prepare the final Amending Standard on Fees.

The inclusion of guidance on fee categories in the Code will be added to the Issues Register and reconsidered once the AASB has progressed their project of audit fee disclosures further.

## Staff Recommendations

Subject to the Board's review comments, the Board:

(a) Determine the preferred options for revisions to the proposed fee provisions;

(b) Approve the revisions in the Amending Standard *Amendments to Fee-related provisions of APES 110 Code of Ethics for Professional Accountants (including Independence Standards)* based on:

  (i) the IESBA final pronouncement: *Revisions to Fee-related provisions of the Code*;

  (ii) references to APES 320 and quality management standards; and

  (iii) the PJC Inquiry recommendation on audit partner incentivisation;

(c) Approve the deferral of the inclusion of audit fee categories In the Code to align with the current AASB project on audit fee disclosures; and

(d) Approve the re-exposure for 30 days of the redrafted provisions relating to fee dependency on a referral source.

## Materials Presented

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| Agenda Item 10 (a) | Proposed wording for fee dependency on a referral source provisions; |
| Agenda Item 10 (b) | General Comments Table – ED 03/21; |
| Agenda Item 10 (c) | General Comments Table – ED 03/21: Attachment 1; |
| Agenda Item 10 (d) | Specific Comments Table – ED 03/21; |
| Agenda Item 10 (e) | Specific Comments Table – ED 03/21: Attachment 1; and |
| Agenda Item 10 (f) | Regulators Comments Table – CONFIDENTIAL (distribution to Board Members only) |

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**Date:** 4 March 2022