

# Parliamentary Joint Committee on Corporations and Financial Services

## Regulation of Auditing

Answers to questions on notice from 7 February 2020

Accounting Professional and Ethical Standards Board

### 1. QUESTION – Prohibitions and Non-Audit Services (pages 2-3 of the Hansard)

**Senator WHISH-WILSON:** I couldn't find any, but, if there were, I'd be interested to know. I want to ask you about what you've provided to the committee—and I think you've given us another sheet this morning for distribution. There is a statement here that says, in the third paragraph:

The independence assessment must also consider the aggregate impact of multiple threats to independence, including where the fees in respect of multiple audit clients referred represent a large proportion of total fees for the firm.

Can you define what you mean by 'a large proportion'? Is there anything prescribed as to what that might be or is that subjective?

**Mr Wijesinghe:** It could be subjective. In the EU they look at 70 per cent.

**Senator WHISH-WILSON:** Seventy per cent of fees or revenue or—?

**Mr Wijesinghe:** Are you talking about non-audit services versus audit services?

**Senator WHISH-WILSON:** Yes.

**Mr Wijesinghe:** In the EU they look at 70 per cent, which is an average over three years of the audit fee versus non-audit services. So that could be a benchmark you could consider.

**Senator WHISH-WILSON:** I'd be interested to write to you about that. I put some questions on notice to the big four accounting firms to ask them what their breakdown was, and the majority of them had more than 70 per cent of their revenue from non-assurance versus audit services. I'd like to follow that up with you, if that is a benchmark you're suggesting.

**Mr Wijesinghe:** I don't think we are suggesting it. I gave you a broad—

**Senator WHISH-WILSON:** You gave me a number from the European Union. Do you think it should apply to Australia? It's clearly within that ball park.

**Senator O'NEILL:** Clearly—and you might need to provide this on notice—the EU didn't do that in the absence of a context. Do you have any understanding of why the EU established such a firm guideline about the separation of the nature of work that auditors could and could not undertake?

**Mr Wijesinghe:** I was talking about a fee benchmark. That came out of the global financial crisis when the EU did a lot of audit reform.

**Senator O'NEILL:** So it's a containment device, which is set at 70 per cent, to increase the likelihood that there is more probity and less conflict of interest in the reporting of entities to the public. Is that essentially what it's designed to do?

**Mr Wijesinghe:** Yes. I can't remember the history—

**Senator WHISH-WILSON:** If we put these to you on notice, you can provide more detail on them, and we can tick-tack on them, because I think it's a really critical issue.

**Senator O'NEILL:** And I think the response about the global financial crisis is very, very helpful. It's about transparency.

### ANSWER:

In our opinion, it is important to appreciate that:

- most of the non-audit services that are provided by an audit firm are provided to clients that are not audited by the firm.
- Even when providing non-audit services to non-audit clients, the audit firm will still need to meet the conflicts of interest requirements of the Code and the applicable requirements of specialist APESB standards such as Valuation Services, Forensic Accounting Services or Insolvency Services;
- APESB standards prohibit an auditor from providing certain types of non-audit services to audit clients, and only permit an auditor to provide other types of services;

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- the fees that an auditor derives from audit and non-audit services are disclosed in financial statements pursuant to [AASB 1054 Australian Additional Disclosure](#), a standard issued by the Australian Accounting Standards Board; and
- In the Australian market, there are some interesting trends of non-audit services provided to audit clients as per the research evidence in [AUASB's Research Report 4: The Provision of Non-Audit Services by Audit Firms in Australia 2012-2018](#) authored by Professor Elizabeth Carson.

We provided copies of this research report and the APESB Guidance document [APES 110 Public Interest Entities Prohibitions](#) to the PJC on the 7<sup>th</sup> of February 2020.

The Financial Reporting Council of the United Kingdom published a revised Ethical Standard in December 2019, which provides that, in respect of public interest entities, the fees earned by an auditor from the provision of permitted non-audit services to a client are not to exceed 70% of the average fees paid in the last three consecutive financial years for the statutory audit of that client. The UK ethical standard is available [here](#).

The revised UK standard is consistent with [EU Audit Regulation no 537/2014](#), which was released by the European Commission in 2014.

The fee cap is explained in a [note issued by the Committee of European Auditing Oversight Bodies](#).

The background to the revisions on audit policy by the European Commission is set out in the memo from the European Commission website [Green Paper on Audit Policy – frequently asked questions](#).

#### **IESBA Proposals – issued 21 January 2020**

As noted in APESB's opening statement to the PJC Inquiry on 7<sup>th</sup> February 2020, the International Ethics Standards Board of Accountants (IESBA) has recently issued global proposals to further strengthen the non-assurance services and fees provisions of the *Code of Conduct*. Please refer below to information related to these global proposals from IESBA's website:

- [IESBA – Non-Assurance Services ED](#)
- [IESBA – Fees ED](#)

A high-level summary of these proposals is provided for the PJC's information in **Appendix A**.

APESB is participating in the due process of IESBA's consideration of these issues. It is expected that in due course, once IESBA finalises its global exposure drafts on Non-assurance Services and Fees, APESB will follow its due process, which will result in a revised Australian Code.

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It is also expected that these proposed IESBA amendments will substantially align the global Code (and in due course APES 110) with the US independence requirements.

We draw the PJC's attention to our opening statement where we noted that IESBA will shortly be commencing a process to develop an authoritative document to benchmark the global Code (which is the basis for APES 110) with the US and EU Independence requirements.

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### Appendix A – High-Level Summary of IESBA EDs issued on 21<sup>st</sup> of January 2020

#### Non-assurance services

The proposals in this project will apply stricter prohibitions as to the types of non-assurance services that can be provided to a PIE audit client. NAS provisions for PIEs will be different from non-PIEs – which is a deliberate position.

The proposed amendments include:

#### For PIE audit clients

- A new prohibition on firms to disallow the provision of non-assurance services to PIE audit clients if it creates a self-review threat (meaning there is a risk that the firms will review the results of previous judgements they made as part of the non-assurance service and on which they will rely when forming their audit opinions);
- an explicit requirement for the auditor to gain concurrence from those charged with governance of the client before providing non-assurance services;
- the removal of the materiality qualifier/threshold (meaning that more types of non-assurance services will not be able to be performed by the auditor of a PIE) for the following non-assurance services:
  - valuation services
  - calculating current and deferred tax liabilities (or assets)
  - tax planning or other tax advisory services
  - valuation for taxation services
  - advocacy role in disputes or litigation for tax or for other matters
  - corporate finance services
  - internal audit services
  - IT system services
- a new prohibition on the marketing, planning, or opining on a tax treatment initially recommended by the firm, and a significant purpose of which is tax avoidance, unless that treatment is most likely to prevail in tax law and regulation.
- a new prohibition on acting as an expert witness in a dispute involving a PIE audit client unless appointed by a tribunal or court.

#### For all audit clients

- Prohibition on assuming management responsibilities will move to Section 400 (so no longer specific to just NAS).
- an explicit requirement for the auditor to communicate with those charged with governance of the client about the provision of non-assurance services; and
- the removal of the materiality qualifier/threshold for tax planning and advisory services and corporate finance services when advice is dependent on particular accounting treatment or presentation that the audit team has doubts about.

## **Fees**

The proposals in this project will consider how fee-related provisions impact perceived auditor independence. The proposals are not attempting to regulate fees or change the client-payer business model.

The proposed amendments include:

### For PIE audit clients

- Maintains the fee dependency threshold of 15% assessed over two consecutive years;
- A new requirement for a firm to cease to be the auditor if fee dependency continues for five consecutive years unless they receive authority from a regulatory body or a pre-issuance review is conducted by an independent accountant
- A new requirement to communicate with those charged with governance on fee dependency, and whether the firm should continue as an auditor.
- A new requirement for firms to ensure audit fee information is publicly available – either made available by the client; otherwise, the auditor needs to disclose the information. The fee information needs to include fees paid or payable to the firm and network firms, fees for other services and any fee dependency issues.
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### For non-PIE audit clients

- New requirements relating to fee dependency, which is assessed over five consecutive years and should be no more than 30% of the total fees received by the firm.

### For all audit clients

- A new requirement to determine threats to independence created by the fees proposed prior to accepting an audit engagement and to re-evaluate through the provision of the audit service.
- A new requirement for firms not to be influenced by the provision of other services to an audit client.
- A new requirement to communicate with those charged with governance on the level of fees for audits and reviews, the analysis, and the steps undertaken to ensure the level of fees does not impact threats being at an acceptable level.
- A new requirement to communicate with those charged with governance on the impact of fees received for other services on ensuring threats are at an acceptable level for the audit engagement.