ASSIREVI

The Chairman

International Ethics Standards Board for Accountants
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017

4 June 2020

Proposed Revisions to the Fee-related Provisions of the Code

Dear Sirs:

Assirevi is the association of the Italian audit firms. Its member firms represent the vast majority of the audit firms licensed to audit companies listed on the Italian stock exchange and other public interest entities in Italy, under the supervision of CONSOB (*Commissione Nazionale per le Società e la Borsa*).

Assirevi promotes technical research in the field of auditing and accounting and publishes technical guidelines for the benefit of its members. It collaborates with CONSOB, the Italian accounting profession and other bodies in developing auditing and accounting standards.

Assirevi is pleased to submit its comments on the Exposure Draft "*Proposed Revisions to the Fee-related Provisions of the Code*" issued by IESBA in January 2020, as detailed in the enclosed document.

Should you have any queries, please do not hesitate to contact us.

Yours faithfully,

Gianmario Crescentino
Chairman

(Enclosure)

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COMMENTS ON THE IESBA EXPOSURE DRAFT

Proposed Revisions to the Fee-related Provisions of the Code

(January 2020)

Assirevi is grateful for the opportunity provided with the above-mentioned Consultation Paper and is pleased to contribute by providing the following comments on the project described therein.

Our Association fully agrees with the objective of strengthening "*the fee-related provisions of the Code so that they remain robust and appropriate in enabling professional accountants to meet their responsibility to comply with the fundamental principles and be independent*". Nonetheless, we wish to draw IESBA's attention to certain issues arising from the Exposure Draft.

Firstly, as already outlined in our previous response to the IESBA Consultation Paper "*Proposed Revisions to the Non-Assurance Services Provisions of the Code*", we wish to highlight that the Code of Ethics was created with a principle based approach and has substantially been relying on this approach until today. This characteristic has rendered the Code a highly useful document aimed at steering auditors' behavior also in the context of different (and not always consistent) national legal frameworks.

Instead, the Exposure Draft covered in this letter, as well as other recent projects on the revision of the Code, seems to be trending progressively away from the original principle based approach, and turning to more of a rule based approach, which would better match enforcement purposes. However, in Assirevi's view, this change would not be suitable to regulate the multiple issues connected to fee matters, as much as it is not suitable to handle certain independence issues relating to the provision of non-audit services. In this respect, reference is also made to our response to the IESBA Consultation Paper on non-assurance services sent on 2 June 2020.

With regards to fee matters, if the Code were to adopt a rule based approach this might give rise to the risk of i) undermining the guidance and steering function of the Code; ii) creating overlaps between the provisions of the Code and the existing set of rules that regulate such matters within national and supranational legal systems; and iii) generating conflicts and mismatches between those various provisions. Indeed, both the European and the Italian legal systems (the latter even before the transposition of the EU rules into national law) already include specific provisions aimed at avoiding the risk that any financial issues regarding the engagement could impact the auditor's independence. This especially emerges from questions no. 1, 2 and 3 of the Exposure Draft (*Evaluating Threats Created by Fees Paid by the Audit Client*).

In the Italian legal system, pursuant to Art. 13, paragraph 1, of Legislative Decree 39/2010, it is for the shareholders' meeting to resolve upon the auditor's fees, on the basis of a proposal made by the board of statutory auditors (i.e. the equivalent of the audit committee in the Italian legal system). Therefore, the amount of the fees is not established by the board of directors, whose activity is subject to audit. Such amount is determined by the shareholders, who - together with the other stakeholders - are the actual users and beneficiaries of the audit, in the context of a process that

includes the intervention of the board of statutory auditors to oversee the multiple independence and audit quality-related aspects involved in the determination of the fees.

Furthermore, the Italian Legislator, in order to safeguard the auditor's independence, has provided that fees for audit engagement "*shall not be established on the basis of the results of the audit, and shall not depend in any way on the provision of non-audit services to the audit client, its controlled undertakings and parent undertakings, by the auditor or the audit firm or their network.* [...] *The fee for the audit engagement shall be determined in such a way as to ensure the quality and reliability of the work*" (see Article 10, paragraphs 9 and 10 of Legislative Decree 39/2010). This provision transposes the European legislation, in particular with respect to Art. 25 of Directive 2014/56/EU, which sets forth that "*Member States shall ensure that adequate rules are in place which provide that fees for statutory audits: (a) are not influenced or determined by the provision of additional services to the audited entity; (b) cannot be based on any form of contingency*".

Art. 4 of EU Regulation 537/2014 sets out a fee cap with respect to the provision of non-audit services in favor of public interest entities. Indeed, if the statutory auditor provides allowed non-audit services in favor of a public interest entity and/or its parent undertaking and/or controlled undertakings "*for a period of three or more consecutive financial years*", the "*total fees*" for such services "*shall be limited to no more than 70 % of the average of the fees paid in the last three consecutive financial years for the statutory audit(s) of the audited entity and, where applicable, of its parent undertaking, of its controlled undertakings and of the consolidated financial statements of that group of undertakings*".
Moreover, pursuant to Art. 5 of EU Regulation 537/2014, the board of statutory auditors (i.e. the equivalent of the audit committee in the Italian legal system) shall approve in advance the allowed non-audit services, thereby monitoring the fees to be paid to the auditor, in compliance with the cap set out by Art. 4 referred to above.

In addition, audit firms are subject to specific duties of disclosure regarding the fees that they have received. In this regard, Art. 13, paragraph 2, letter k) of EU Regulation 537/2014 requires the auditors to provide into their transparency report - unless such information has been disclosed in their financial statements within the meaning of Article 4(2) of Directive 2013/34/EU - *"information about the total turnover of the statutory auditor or the audit firm, divided into the following categories: (i) revenues from the statutory audit of annual and consolidated financial statements of public-interest entities and entities belonging to a group of undertakings whose parent undertaking is a public-interest entity; (ii) revenues from the statutory audit of annual and consolidated financial statements of other entities; (iii) revenues from permitted non-audit services to entities that are audited by the statutory auditor or the audit firm; and (iv) revenues from non-audit services to other entities*"[(1)].

[(1)] Furthermore, article 14 of the EU Regulation 537/2014 states that "*Statutory auditors and audit firms shall provide annually to his, her or its competent authority a list of the audited public-interest entities by revenue generated from them, dividing those revenues into: (a) revenues from statutory audit; (b) revenues from non-audit services other than those referred to in Article 5(1) which are required by Union or national legislation; and, (c) revenues from non-audit services other than those referred to in Article 5(1) which are not required by Union or national legislation*".

As far as the disclosure of fees is concerned, listed companies in Italy are required to present a statement in attachment to their financial statements, whereby information must be provided in respect of the fees paid in the relevant financial year to the statutory auditor and/or its network for audit and non-audit activities carried out in favor of such listed company and its subsidiaries.

Assirevi deems it useful to draw the attention to the provision under Art. 4, paragraph 3, first sentence, of EU Regulation 537/2014, pursuant to which "*When the total fees received from a public-interest entity in each of the last three consecutive financial years are more than 15 % of the total fees received by the statutory auditor or the audit firm or, where applicable, by the group auditor carrying out the statutory audit, in each of those financial years, such a statutory auditor or audit firm or, as the case may be, group auditor, shall disclose that fact to the audit committee and discuss with the audit committee the threats to their independence and the safeguards applied to mitigate those threats. The audit committee shall consider whether the audit engagement should be subject to an engagement quality control review by another statutory auditor or audit firm prior to the issuance of the audit report*" [(2)]. The above provision is clearly aimed at mitigating the risk that auditors might financially depend on audit clients.

The regulatory framework described above seems appropriate in order to prevent the risk that the financial aspects of the engagement might impact the auditor's independence. Therefore, according to Assirevi, if the IESBA were to confirm the orientation to implement a rule-based approach (as resulting from the Exposure Draft), this would inevitable result in i) risks of conflict between the Code and the regulatory framework described above, and ii) implementation issues.

In conclusion, the transposition of the Code of Ethics at national level is frequently impacted by the concurring existence of local legal systems which are significantly more complex than the framework which the international standards on auditing issued by the IAASB are confronted with when it comes to their endorsement. In fact, this latter framework is less articulated in terms of legislation and therefore less subject to risks of overlap.

In light of (and in addition to) the above, please find below some further comments relating to specific questions contained within the explanatory memorandum of the Exposure Draft.

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(2) Article 4, paragraph 3, second sentence "*Where the fees received from such a public-interest entity continue to exceed 15 % of the total fees received by such a statutory auditor or audit firm or, as the case may be, by a group auditor carrying out the statutory audit, the audit committee shall decide on the basis of objective grounds whether the statutory auditor or the audit firm or the group auditor, of such an entity or group of entities may continue to carry out the statutory audit for an additional period which shall not, in any case, exceed two years*".

4. Do you support the requirement in paragraph R410.6 that a firm not allow the level of the audit fee to be influenced by the provision by the firm or a network firm of services other than audit to the audit client?

Assirevi supports the principle underlying this rule. The level of audit fees shall not be affected by fees originating by non-audit services. Nonetheless, in the Association's opinion, if the IESBA were to express this principle through the rule set forth in paragraph R410.6, this would give rise to significant practical issues, especially with regard to how compliance with this provision should be documented.

The determination of audit fees is the outcome of a business decision that takes into account several facts and circumstances relating to the engagement. As indicated in paragraph 410.6 A1, the level of audit fees is influenced by various factors, such as the level of complexity of the engagement, the resources required both in quantitative and qualitative terms, the quality of the financial reporting preparation and control processes put in place by the entity, and the applicable financial framework. Moreover, the level of audit fees is also influenced by factors falling outside the specific scope of the engagement, such as the market in which the audit firm and the audited entity operate, or business reasons that an audit firm might follow in order to be granted an engagement connected to a specific industry or geographical market.

In this respect, it is worth noting that the guideline set forth in paragraph 410.6 A2 also clarifies that R410.6 is not intended to prevent cost savings achieved due to the experience that an auditor might have gained through the provision of non-audit services. This implicitly acknowledges the legitimacy of certain circumstances in which the provision of non-audit services can indirectly influence the level of audit fees.

In light of the above, it would be hard to identify the documentation requested to support compliance with this provision – which would inevitably entail the risk that a generic declaration of compliance might eventually satisfy the request, without any actual value being added to the quality of the audit.

5. Do you support that the guidance on determination of the proportion of fees for services other than audit in paragraph 410.10 A1 include consideration of fees for services other than audit:

(a) Charged by both the firm and network firms to the audit client; and

(b) Delivered to related entities of the audit client?

Assirevi agrees with the proposed provision under paragraph 410.10.A1. Such principle is consistent with the Italian legal system. It would be useful to clarify the scope of “related entities” to be considered. In Assirevi's view, only those entities which are actually controlled by the audited entity, or over which the latter can exercise a significant influence, should be considered. With regard to listed companies, Assirevi believes that (i) companies in which the listed company holds more than 20% of the share capital but is not able to exercise significant influence and (ii) the entities under common control with the listed company should be excluded. In fact, in those cases, the decision-making process connected to the assignment of non-audit engagements would not fall under the purview and/or the control of such listed company.

6. Do you support the proposal in paragraph R410.14 to include a threshold for firms to address threats created by fee dependency on a non-PIE audit client? Do you support the proposed threshold in paragraph R410.14?

Assirevi agrees that a consistent application of the provisions of the Code would be appropriate in carrying out the risk assessment of the self-interest and intimidation threats that may arise when the level of fees received by an audit client represents a significant percentage of the overall fees received by the auditor. However, in our opinion, neither the identification of a fixed threshold is consistent with the principle based approach underpinning the Code, nor is this responsive to any actual issues faced in practice. As a matter of fact, the application of the proposed threshold may lead to unintended consequences due to various factors, such as the existing differences in national legal frameworks, the different (and not always consistent) features of the audit, the size and operating structure of the audit firms. In fact, the largest audit firms, given the number of clients they serve and the related volume of business, have already implemented procedures and policies aimed at monitoring the fees received from their clients (sometimes setting thresholds that are even more stringent than those proposed by the Code). Conversely, medium and small audit firms could take advantage of a conceptual framework (and the principles thereof) that could represent a guide in the assessment of self-interest and intimidation threats created by fee dependency. However, also in this perspective, setting out a unique threshold for both big, small and medium audit firms would nonetheless create issues for the latter two categories.

In light on the above, it is the view of Assirevi that a different approach providing appropriate relevance to important qualitative aspects and not only to the circumstance that a fixed quantitative threshold has been exceeded, would certainly be preferable.

7. Do you support the proposed actions in paragraph R410.14 to reduce the threats created by fee dependency to an acceptable level once total fees exceed the threshold?

As anticipated, Assirevi does not agree with the view that a fixed threshold should be established. Notwithstanding the above, we believe that, should the analysis of quantitative and qualitative factors reveal a situation of fee dependency, the proposed actions would be appropriate in order to reduce the self-interest and intimidation threats arising from such situation.

8. Do you support the proposed action in paragraph R410.17 to reduce the threats created by fee dependency to an acceptable level in the case of a PIE audit client?

Assirevi believes that the actions proposed in paragraph R410.17 are appropriate in order to reduce the threats created by fee dependency to an acceptable level, especially if such actions are matched with those set out in paragraphs R410.20 and R.410.24, which provide that both the specific circumstances and the related safeguards should be communicated to those charged with governance (hereinafter, "TCWG").

Assirevi also draws the attention of the IESBA to the fact that the proposed revision should be coordinated with ISA 260 to avoid any potential overlap between the information flows required by the two sets of standards.

Moreover, it would also be useful to specify that the professional accountant in charge of the engagement quality review "*who is not a member of the firm*" may be a partner of another member firm belonging to the same network of the auditor.

9. Do you agree with the proposal in paragraph R410.19 to require a firm to cease to be the auditor if fee dependency continues after consecutive 5 years in the case of a PIE audit client? Do you have any specific concerns about its operability?

Assirevi regards as remote the circumstance identified in paragraph R410.19, where reference is made to a particularly long-lasting situation of fee dependency (5 years). In such cases, under the EU and Italian legal framework, TCWG are already expected, well before the end of the above period, to assess whether the audit firm can continue to perform the statutory audit, on the ground of valid reasons. TCWG should carefully evaluate the threats to independence, on the one side, and the impact of the decision to terminate early the audit engagement, on the other hand.

10. Do you support the exception provided in paragraph R410.20?

Please see our response to question 9. above.

11. Do you support the proposed requirement in paragraph R410.25 regarding public disclosure of fee-related information for a PIE audit client? In particular, having regard to the objective of the requirement and taking into account the related application material, do you have views about the operability of the proposal?

Assirevi agrees that public disclosure of fee-related information, both for audit and non- audit services, supports stakeholders in "*facilitating their judgements and assessments about a firm's independence*".

However, as per our overarching comment outlined in the introduction to our response, we believe that the principle based approach on which the Code was established should be preserved, since turning this into a rule based approach would i) undermine its guidance and steering function and ii) might lead to potential mismatches between the Code and the set of rules already in force within certain national and supranational legal systems.

In light of the above, in our view, the Code should clarify that if both the Code and local regulation require certain information to be disclosed, then the auditor should be deemed as having satisfied the provision of the Code by complying with local regulation.

Moreover, with regard to information required at paragraph R 410.25, letter a) ii ("*actual or estimated fees paid or payable to other firms that have performed audit procedures on the engagements*"), Assirevi does not agree that such information would be useful to "*stakeholders in making judgements about independence of those involved in the group audit different from the firm expressing the opinion*". According to Assirevi, such information should therefore be removed from paragraph R410.25. This conclusion arises from the following considerations:

1. The amount of fees paid to "*other firms*" for the audit activities they have performed does not allow stakeholders to verify the independence of such

"*other firms*". Fees are indeed influenced by several factors which are unrelated to independence, such as the extension of the procedures performed and the average level of fees within the Country where the "*other firm*" is based;

2. The IESBA itself acknowledges that "*fee information from component auditor outside the firm's network might not be readily available*" and, accordingly, limits the disclosure only to the audit fees. Nonetheless, information on audit fees does not allow to assess the auditor's independence if it cannot be compared with information on non-audit services fees;
3. ISA 600 is based on the principle that the group auditor is the only responsible party for the audit opinion on the consolidated financial statements, even if other firms have performed audit activities on the components, so that paragraph 11. of such International Standard sets forth that "*the auditor's report on the group financial statements shall not refer to a component auditor*" (i.e., the "*other firm*"). Such principle could end up being weakened by mentioning information on the level of fees that the "*other firms*" have received for the performance of component audit work in the context of the group audit. In fact, a quantitative information on the involvement of the component auditor would be provided, with a risk of misperception by the stakeholders as to the responsibility for the audit opinion on the consolidated financial accounts by the group auditor;
4. The exception provided in paragraph 410.26 confirms that the group auditor could in fact face difficulties in obtaining and verifying the information regarding the "*other firms*", also considering that the group auditor has no right to obtain such information. It is the view of Assirevi, however, that this exception is overly complex, compared with the relevance that data related to the "*other firms*" could have for the stakeholders.

12. Do you have views or suggestions as to what the IESBA should consider as:

(a) Possible other ways to achieve transparency of fee-related information for PIEs audit clients; and

(b) Information to be disclosed to TCWG and to the public to assist them in their judgments and assessments about the firm's independence?

Please see our response to question 11. above.