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Mr. Ken Siong
International Ethics Standards Board for Accountants
International Federation of Accountants
529 Fifth Avenue
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4 June 2020

Dear Mr. Siong:

Proposed Revisions to the Fee-related Provisions of the Code

Ernst & Young Global Limited, the central coordinating entity of the Ernst & Young organization, is pleased to comment on the International Ethics Standards Board for Accountants' (the "IESBA" or the "Board") Exposure Draft, Proposed Revisions to the Fee-related Provisions of the Code (the ED).

We are supportive of the IESBA's efforts to enhance the provisions of the International Independence Standards of the IESBA's Code of Ethics (the Code), and there are certain aspects of the IESBA's proposed changes that we agree with, and which we believe contribute to a more robust Code. However, as more fully explained in our responses below, there are certain proposed changes that we believe warrant further consideration by the IESBA and we hope our comments will aid the IESBA in their efforts.

Fifteen specific questions were identified on which the Board welcomed respondents' views and we have organized our response accordingly. Our comments are set out below.

Evaluating Threats Created by Fees Paid by the Audit Client

1. Do you agree that a self-interest threat to independence is created and an intimidation threat to independence might be created when fees are negotiated with and paid by an audit client (or an assurance client)?

No, we do not agree with the IESBA that a self-interest threat to independence is created and an intimidation threat to independence might be created when fees are negotiated with and paid by an audit client (or an assurance client). We do agree that a self-interest and intimidation threat may be created when there is a fee dependency.

This payment model has long existed, and as described by the IESBA in paragraph 22 of the Explanatory Memorandum, it is a practice that is generally recognized and accepted by intended users of the financial statements. This payment model works because professional standards exist that provide systematic guidelines that help ensure the accuracy, consistency, and verifiability of firms' actions and reports. We strongly believe that compliance with professional standards, including ethical requirements, is more than just an important factor in mitigating potential self-interest threats to independence resulting from fees being negotiated with and paid by the audit client, and is in fact a significant basis for asserting that such a threat to independence is non-existent. This is because if a firm complies with the professional standards, the audit will be conducted in a manner that is appropriate regardless of the parties involved in negotiating and paying the fee. Having an effective system of quality control under existing standards and proposed International Standard on Quality Management (ISQM) 1, Quality Management for Firms

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that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements functions to eliminate a self-interest threat that may be created due to the payer model. As noted in the explanatory memorandum to IAASB's Exposure Draft, Proposed International Standard on Quality Management 1 (Previously Internal Standard on Quality Control 1), this standard will require firms to implement and operate a system of quality management to ensure that firms and their personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and that engagement reports issued by the firms are appropriate in the circumstances.

Fees are based on the cost of resources to be utilized, expertise needed, complexity and geographic spread of the client's operations and the expected time to be spent commensurate on scope, scale and complexity of the audit. Market pricing is also a factor.

Given the purpose of the audit[1] and the role of the professional accountant[2], we believe it is inappropriate for the Code to contain content that suggests that the independence of the firm should already be called into question by merely participating in a free-market fee negotiation and settlement. We, therefore, do not believe there is a need for the Code to conclude that there is any inherent self-interest threat in the audit client payer model, and that doing so undermines the profession and the purpose of the audit, and is not in the public interest. The Code should identify potential threats and not set forth an assumption that the mere acceptance of the audit engagement should be considered a threat to a firm's independence when the fees are negotiated with and paid by the audit client. In that regard, we recommend that paragraphs 410.3 A1 and 410.4 A1 be removed, and 410.4 A2 reworded to state:

> "Factors that are relevant in evaluating the level of threats ~~created when~~ related to fees charged for an audit or any other engagement ~~are paid by the audit client~~ include: …".

Further, we recommend that proposed paragraph 410.4 A3 give more significance to proposed ISQM 1 by replacing the word "might" with "will likely".

2. Do you support the requirement in paragraph R410.4 for a firm to determine whether the threats to independence created by the fees proposed to an audit client are at an acceptable level:
(a) Before the firm accepts an audit or any other engagement for the client; and
(b) Before a network firm accepts to provide a service to the client?

No, we do not believe the requirement in paragraph R410.4 is necessary. We believe that the proposed requirements with regard to level of audit fees (R410.6), contingent fees (R410.8 and R410.9), overdue fees (R410.12), and fee dependency (R410.14 – R410.20) adequately address the relevant risks related to fees. Further, the proposed requirement in R410.4 would add significant documentational burden without a commensurate benefit to the public interest. The IESBA should undertake further cost/benefit study prior to implementing such a requirement.

[1] ISA 200, Section 3: The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial framework
[2] IESBA Code, 100.1 A1: A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. A professional accountant's responsibility is not exclusively to satisfy the needs of an individual clients or employing organization. Therefore, the Code contains requirements and application material to enable professional accountants to meet their responsibility to act in the public interest.

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We would like to point out the summary of the academic research commissioned by the IESBA in 2016 in which Professor Hay noted:

> "There is a mixture of risks to auditor independence that are confirmed by the research evidence; risks that are not confirmed; and risks where evidence is mixed. There is no evidence of auditors using the audit as a loss-leader to obtain more lucrative consulting work. There are few signs of audit fees being too low to be able to conduct an adequate audit.
>
> "Nevertheless, there is evidence of some issues of concern, including non-audit services associated with indications of reduced independence; and non-audit services leading to reduced independence in appearance. There is some concern about the audit services provided by firms that have substantial non-audit service businesses.
>
> "In general, audit fee research does not convey a message that there are widespread ethical problems [underline added]. Nevertheless, there are some risk areas."[3]

3. Do you have views or suggestions as to what the IESBA should consider as further factors (or conditions, policies and procedures) relevant to evaluating the level of threats created when fees for an audit or any other engagement are paid by the audit client? In particular, do you support recognizing as an example of relevant conditions, policies and procedures the existence of an independent committee which advises the firm on governance matters that might impact the firm's independence?

As stated above, we do not agree with the IESBA that there is a presupposition that a self-interest threat to independence is created and an intimidation threat to independence might be created when fees are negotiated with and paid by an audit client.

In addition, the IESBA should give greater recognition and acknowledgment of such standards as the current standards on systems of quality control and proposed ISQM 1 and the International Standard on Auditing (ISA) 220. Both these standards deal with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements.

We do not support recognizing as an example of relevant conditions, policies and procedures the existence of an independent committee which advises the firm on governance matters. The Explanatory Memorandum notes in paragraph 30 that there were views that inclusion of this example as a factor would go beyond the remit of this project, and we agree with this view. Further, members of such an independent committee would be required to achieve personal independence under the Code in order to have a say over fees for any given client. This raises serious practical considerations besides adding undue cost burdens to audit processes. We do not believe it would be appropriate for the IESBA to address matters regarding the governance of a firm. We believe governance of a firm is adequately covered by existing standards on quality control and proposed ISQM 1.

Lastly, an appropriate fee level for a particular audit engagement depends on many factors and it is not practicable for a Code with global application to prescribe a specific fee level, not least because of anti-completion laws in many jurisdictions.

[3] David Hay, December 2016, "Audit fee research on issues related to ethics", Agenda Item 6-A from the IESBA December 2006 meeting.

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Impact of Services Other than Audit Provided to an Audit Client

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?

We agree that the fee for an audit engagement must be a standalone fee and should reflect the cost of resources to be utilized, expertise needed, complexity and geographic spread of the client's operations and the expected time to be spent commensurate on scope, scale and complexity. Accordingly, the provision of other services by the firm or a network firm to the audit client should not be factored into the fee for the audit engagement.

However, is important to recognize that the knowledge and understanding of the audit client gained by the firm when providing other services to an audit client typically provide the firm with insights into the operating, environmental, legal and financial characteristics, as well as various risk factors, associated with the audit client. This knowledge and understanding allows the audit firm to focus appropriate efforts and resources on the specific risks associated the audit client, thereby enhancing audit quality. We do not believe that the utilization of this knowledge and experience in setting the fee for the audit engagement would be deemed to be influencing the audit fee.

Proportion of Fees for Services Other than Audit to Audit Fee

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?

We do not support paragraph 410.10 A1 as it is drafted because it presupposes that a self-review threat already exists because the audit fees were negotiated with and paid by the audit client. As noted in our response to question one above, we do not agree with this assumption.

In our view, the Code should take a principles-based approach using the extant framework and provide the flexibility for firms to evaluate the threats created by the proportion of the fees for the other services delivered throughout the period during which independence is required. The proportion of fees as a standalone measure is not an appropriate measure, but rather the totality of the various factors involved in delivering the service, including the complexity of the client and services, need to be considered.

Consistent with our prior comments, the IESBA should consider acknowledging standards such as the existing standards on quality control systems, proposed ISQM 1 and ISA 220. These standards deal with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. Specifically, ISA 220 addresses, where applicable, the responsibilities of the engagement quality control reviewer which is a significant safeguard to such self-interest and intimidation threats.

The proposed changes do not provide any guidance on what will constitute a "large proportion", and do not adequately explain what fees should be included in the numerator and denominator when computing the proportion. For example, would the audit fee only include the fees for the audit of the financial statement that are being reported upon, or would this also include the fees for

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statutory audits of subsidiaries in various jurisdictions, quarterly reviews, etc.? In addition, application material would need to be provided to address questions on how the fees for services other than audit, but for which the audit is integral to the other service, or the service can only be reasonably provided by the auditor, should be factored in to the evaluation – for example, comfort letters, consents, certain services required for regulatory filings and other assurance services.

Application material should make it clear that the fees for other services only relate to the audit client and related entities over which the audit client has direct or indirect control.

Finally, consideration should be given to potential difficulties some networks may face where such networks do not have common accounting or financial reporting systems such that global fees for a client may not be readily available.

Fee Dependency for non-PIE Audit Clients

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?

We are supportive of the proposal in paragraph R410.14 to include a threshold for firms to address threats created by fee dependence on a non-PIE audit client, and do not take exception to using a 30% threshold as proposed.

We do not agree with the current drafting of proposed paragraph 410.13 A1 because it presupposes that a self-review threat already exists because the audit fees were negotiated with and paid by the audit client. We recommend that proposed paragraph 410.13 be revised as follows:

> "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, and concern about the potential loss of fees from audit and other services from that client ~~impact the evaluation of the level of the~~ creates a self-interest threat and an intimidation threat."

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?

The IESBA should be clearer as to whether an assignment of an engagement quality review would satisfy the requirement under R410.14 (a), or what is expected as to the nature and scope of such a review in order to satisfy the requirement. Consistent with our prior comments, standards such as ISA 220 addresses the responsibilities of the engagement quality control reviewer which could be applied when such safeguards are needed.

We believe the IESBA will need to clarify who "a professional accountant, who is not a member of the firm" can be. Footnote 16 of the Explanatory Memorandum states that, "In line with the Structure drafting guidelines, "firm" does not cover network firms; therefore, it is permitted that the professional accountant who performs the review be a member of a network firm." We believe this should be specifically stated in the application material as well.

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Fee Dependency for PIE Audit Clients

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?

We support the proposed action in paragraph R410.17 to reduce the threats created by fee dependence to an acceptable level in the case of a PIE audit client, but suggest the following circumstance be addressed.

Paragraph 52 of the Explanatory Memorandum makes it clear that the IESBA's intent is that the pre-issuance review required in proposed paragraph R410.17 is the equivalent of an engagement quality review as defined in proposed ISQM 2, Engagement Quality Reviews. As currently drafted, proposed paragraph R410.17 focuses on an engagement quality review being performed and not a pre-issuance review. In some jurisdictions there are requirements that the engagement quality review be performed by a locally licensed professional accountant. In this circumstance, we propose that the requirement in proposed paragraph R410.17 is changed as follows:

> "When for each of two consecutive years the total fees from an audit client that is a public interest entity represent, or are likely to represent, more than 15% of the total fees received by the firm, the firm shall determine whether, prior to the audit opinion being issued on the second year's financial statements, a pre-issuance review equivalent to that of an engagement quality review performed by a professional accountant who is not a member of the firm…."

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?

We agree in principal with the proposal in paragraph R410.19 to require a firm to cease to be the auditor if fee dependency continues in the case of a PIE audit client.

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

Yes, we support the exception provided in proposed paragraph R410.20.

We also would encourage the IESBA to clarify if there could be other compelling reasons when an exception could be taken and the firm could continue to be the auditor – for example, when those charged with governance (TCWG) and those taking part in decisions determine there are circumstances wherein TCWG consider re-appointment of the audit firm to be in the best interests of the entities' stakeholders.

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Transparency of Fee-related Information for PIE Audit Clients

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?

We support transparency and communication with TCWG and the public as an element of safeguarding independence. However, we believe that public disclosure of fee-related information should be the responsibility of the audit client, and therefore should be addressed by the relevant accounting and reporting standards, regulator, or security exchange. We are opposed to the application material in proposed paragraph 410.25 A4 suggesting that disclosing fee-related information would be appropriate in the auditor's report. It is fundamentally incorrect to make the correlation in the auditor's report between fees and independence. The level of the audit fee, taken on its own, is not a measure of audit quality or independence. There is a required affirmative statement in the auditor's report that the auditor is independent. Including a fee disclosure in the same report with a purpose of allowing for the assessment of the level independence is inappropriate and could have unintended consequences. One could interpret it that the audit itself is not of a high quality if the fees appear to be inadequate to the user.

The IESBA notes in paragraph 74 of the Explanatory Memorandum that it is intended that the communication of fees would also include fees paid to non-network firms. We do not believe that fees paid for audit services or NAS to non-network firms who participate in the audit are relevant to the considerations made by TCWG of the audit firms independence since such fees have no bearing on the independence of the firm expressing an opinion on the audit client's financial statements. This is because the audit firm issuing the audit opinion is not a party to the discussions, contractual terms and payment information between the audit client and another service provider. Further, the audit firm would need the client's permission to use confidential information related to the contractual terms with another service provider. In addition, the inclusion of fees from non-network firms is inconsistent with fee disclosures required by other frameworks that currently provide for fee disclosure.

It should be made clear that fees for all audit services, including those for statutory audits of entities over which the client has direct or indirect control, should be included in total audit fees and not just fees for the audit of the group financial statements on which the firm will issue an opinion.

We further believe the IESBA needs to consider the implications the fee-related information disclosure requirements in the context of private equity complexes. We suggest that the application materials make it clear that private equity funds should not have to include fees from each of the individual portfolio companies over which the fund has direct or indirect control. To require inclusion of such fee information will present significant challenges since the audit firm and, in many cases, the audit client will have no ability or right to obtain this information. Therefore, fees paid or payable to the firm and network firms by portfolio companies of private equity funds should not be included in fee disclosures.

Finally, including this requirement in Section 400 would have as a consequence that if a firm cannot comply with the requirement, for example because it is unable to gather the information from network or non-network firms, it would not be considered independent. If the IESBA decides to retain the requirement as drafted, and to include it in Section 400, we suggest that application material similar to extant paragraph 400.60 A1 be included to make it clear that a lack of documentation causing the inability to disclose does not determine whether a firm is independent.

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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?

We believe that there should be a coordination with competent authorities and securities exchanges to establish fee disclosure requirements for companies.

Current standards on systems of quality control and proposed ISQM 1 enhance the robustness of a firm's systems of quality control through various means. There needs to be a greater understanding by the public of how the current standards on systems of quality control and proposed ISQM help reduce threats to independence related to fees.

We support strengthening the communication with TCWG to achieve transparency of fee-related information for PIEs audit clients. We would also encourage IESBA to explore the possibility to differentiate the requirements between listed PIE and non-listed PIE entities and communication with TCWG. There also needs to be a greater understanding by TCWG of requirements such as proposed ISQM 1 and ISA 220 and the rigor of those standards.

The IESBA describes in proposed paragraph 410.25 A3 (b) that if the fee-related information is not disclosed by the audit client, the firm might make the required disclosures in a manner "deemed appropriate for the circumstances." We note that the firm would need to obtain the client's permission to disclose the fee-related information since this would be the client's confidential information. The IESBA should consider what alternatives would be appropriate in the event the client does not disclose the fee-related information and does not grant the firm permission to disclose such client confidential information. Additionally, we further believe it would be helpful if the IESBA consider including as an example under sub-point (b) that as an alternative to including the disclosures in the auditor's report the firm could attach a schedule to the auditor's report that provides for disclosure of the fee-related information, including any additional descriptions that enables the reader to understand the services provided. The information necessary to adequately inform a user about the nature of the services provided related to the associated fee disclosure lends itself to a separate schedule and not in lengthy descriptions within an auditor's report. We note that having such a disclosure approach would be more consistent with approaches taken by other stock exchanges and regulators that require similar disclosures.

Anti-Trust and Anti-Competition Issues

13. Do you have views regarding whether the proposals could be adopted by national standard setters or IFAC member bodies (whether or not they have a regulatory remit) within the framework of national anti-trust or anti-competition laws? The IESBA would welcome comments in particular from national standard setters, professional accountancy organizations, regulators and competition authorities.

The determination of whether the proposals could be adopted by national standard setters or IFAC member bodies within the framework of national anti-trust or anti-competition laws must be answered by those parties. We strongly support a Code that is recognized and fully adopted in all jurisdictions. Thus, if jurisdictions have concerns that they will not be able to adopt the proposed standard, IESBA should address such matters before finalizing a standard.

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Proposed Consequential and Conforming Amendments

14. Do you support the proposed consequential and conforming amendments to Section 905 and other sections of the Code as set out in this Exposure Draft? In relation to overdue fees from an assurance client, would you generally expect a firm to obtain payment of all overdue fees before issuing its report for an assurance engagement?

We believe our comments and concerns noted above need to also be considered with regard to any consequential and conforming amendments in other sections of the Code.

15. Do you believe that there are any other areas within the Code that may warrant a conforming change as a result of the proposed revisions?

As we have described in our responses above, we have significant concerns with the proposed changes, including:

- a presupposition that fees negotiated with and paid by the audit client create a self-interest threat;
- the proposed changes do not give sufficient consideration, recognition and acknowledgement to standards such as existing standards on quality control systems, proposed ISQM 1 and ISA 220; and
- public disclosure of fee information is inappropriate in the auditor's report.

We believe the IESBA should further understand and consider the cost versus the benefit of these proposed changes before including them in a final standard.

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We would be pleased to discuss our comments with members of the International Ethics Standards Board or its staff. If you wish to do so, please contact Tone Maren Sakshaug (tonemaren.sakshaug1@qa.ey.com) or John Neary (john.neary1@ey.com).

Yours sincerely,

Ernst & Young Global Limited