

4 June 2020

Mr. Ken Siong
Senior Technical Director
International Ethics Standards Board
for Accountants
529 Fifth Avenue, 6th Floor
New York
NY 10017, USA

submitted electronically through the IESBA website

Institut der Wirtschaftsprüfer
in Deutschland e. V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0) 211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0) 211 / 4 54 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
IBAN: DE53 3007 0010 0748 0213 00
BIC: DEUTDE33XXX
USt-ID Nummer: DE119353203

Re.: Proposed Revisions to the Fee-related Provisions of the Code

Dear Ken,

We would like to thank you for the opportunity to provide the IESBA with our comments on the Exposure Draft “Proposed Revisions to the Fee-related Provisions of the Code”, hereinafter referred to as “the Exposure Draft”.

Before addressing in the appendix to this letter some of the individual questions raised in the Explanatory Memorandum, we provide some general comments on the proposals contained in the Exposure Draft, some of which are not subject to specific questions.

We have chosen not to respond to the request for general comments as any issues we have from the perspective of small and medium practices are already included in our comments. We have not considered translation issues, as the German Wirtschaftsprüferkammer (WPK) would generally undertake any translation into German. Other perspectives are not relevant to the IDW.

General Comments

Impact of the current Covid-19 pandemic on this project

We appreciate the sensitivity IESBA has recently demonstrated in extending the deadline for comments. Regarding this project, there are two aspects we suggest need further discussion by IESBA.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Daniela Kelm, RA LL.M.;
Melanie Sack, WP StB

Page 2 of 14 to the Comment Letter to the IESBA of 4 June 2020

Firstly, tightening the “package” of requirements aimed at safeguarding auditor independence should not result in denying entities in need of urgent advice at various stages of the Covid-19 pandemic from obtaining this from their auditor. In particular, an auditor’s knowledge of a client’s business and environment may often be key in facilitating the timely, complete, and bespoke advice that will be essential in this time of crisis. For many entities, especially SMEs, obtaining support quickly may be essential to their survival.

Secondly, we believe that the pace of change to the IESBA Code (and – for Germany – any corresponding national alignment initiatives) auditing firms are required to deal with needs to slow down considerably. In determining the effective date, we would urge the IESBA to bear in mind that the strain caused by the current crisis also affects firms and to defer the effective date appropriately.

IESBA’s mandate does not extend to multi-disciplinary business models

We note the discussion in the Explanatory Memorandum concerning IESBA’s role in relation to firms’ multi-disciplinary business models whereby firms often provide audit services together with consulting and advisory services to a wide range of clients.

The IDW firmly agrees with the IESBA contentions that such concerns are beyond the IESBA’s mandate.

We note the discussions in various parts of the world as to multidisciplinary firms but are convinced that this model remains appropriate in today’s increasingly complex environment to ensure firms also have the access to appropriate expertise necessary to safeguard quality audit.

Cost-benefit considerations in proposing onerous requirements

We are increasingly concerned that IESBA seeks to have auditors “prove” their independence; often primarily independence in appearance, by performing detailed work that involves arduous information gathering in complex and geographically spread-out group situations and also additional documentation without either providing evidence for the need to tighten rules or sufficient regard to the associated practicalities and cost-benefit implications.

The notion of independence in appearance seems to be increasingly used as a “carte blanche” to justify the introduction of ever increasingly stringent and rules-based measures in the PIE audit arena that have little to do with the actual

Page 3 of 14 to the Comment Letter to the IESBA of 4 June 2020

impact on the independence of mind of an auditor. Indeed, the explanations in agenda papers are often cited as IESBA's views but lack any firm evidence. In our view, IESBA ought to consider the real impact on auditor independence of mind of proposals in a more holistic manner rather than focusing overly on views about deemed perceptions of appearances, which by nature are highly subjective. Indeed, for an effective IESBA Code designed for global application the IDW has consistently supported a principles-based approach, and consequently is concerned about the sharp increase in proposals that seek to introduce rules and finite criteria, often similar to those in place in particular jurisdictions (including the EU). Clearly where such proposals reflect legislative measures that already apply in Germany, we will not take issue on specific measures: Nevertheless, we are increasingly concerned as to the appropriateness of rules in the absence of evidence-based justification within a globally applicable Code that still purports to be principles-based. We suggest the IESBA be more sensitive to practicalities and cost-benefit implications of its proposals.

The need to clarify the impact of compliance with professional standards as a key factor mitigating the inherent self-interest threat in the audit client payer model

In paragraph 22 of the Explanatory Memorandum, IESBA states its view that a self-interest threat to auditor independence exists, based on the risk inherent whenever the party responsible for the subject of an examination directly pays the examiner. It also notes that this practice is generally recognized and accepted by intended users of financial statements.

IESBA also states its belief that compliance with professional standards is an important factor that acts to mitigate the threat and that firms might often conclude that the level of threat is at an acceptable level (see paragraphs 23, 29 and 31 of the Explanatory Memorandum). We agree with IESBA's belief that (proper) compliance with (appropriate) professional standards addresses this threat such that it does not exceed an acceptable level, and suggest that this may be one factor that explains why intended users of financial statements have generally recognized and accepted the audit client payer model.

We would also like to point out a further key factor IESBA should also recognize, which is that the audit client payer model has also shaped current laws and regulations relating to corporate governance. Accordingly, these also serve to reduce any self-review threat to an acceptably low level. For example, in Germany for an audit client that is a PIE, the supervisory board engages the

Page 4 of 14 to the Comment Letter to the IESBA of 4 June 2020

auditor, the shareholders ratify this at their annual general meeting. For some regulated industries, a particular regulatory authority has a right of approval or veto of the auditor selection,

Whilst IESBA does not have a mandate in respect of the corporate governance systems of an auditor's clients, the independence provisions of the Code must be designed with them in mind. In other words, an alternative model would require very different independence standards.

We suggest IESBA clarify whether it accepts that generally accepted standards such as the international standards on auditing and quality control and its own Code (or equivalents that are at least as stringent) are fit for purpose in this context. For PIEs the existence of an external review mechanism for reviewing the quality of firms' audit work might be an additional factor. If this is the case, instead of requiring all firms to undertake an onerous formal determination (and evidence this with related documentation) of whether the threats are at an acceptable level in respect of each and every engagement, the Code could contain a presumption that the *inherent self-interest threat in the audit client payer model* is at an acceptable level, provided certain factors that increase the threat are absent. The audit firm should then only be required to undertake a formal determination of the level of threat when triggered by the presence of such factors. A further example of such factors would be the use of substantially different professional standards from those generally accepted, a departure from the applicable standards, in addition to those covered in section 410.

In our response to q. 2, we therefore suggest that IESBA debate whether proposed requirement R410.4 can be modified to reflect this approach.

Definition of the term "Public Interest Entity"

We note that the IESBA project concerning the definition of the term "Public Interest Entity (PIE)" has not yet been finalized.

The absence of a firm notion of which entities will be covered by the term PIE, means that it is not possible to comment fully on the proposals in the ED. There could be issues for certain entities that commenters cannot yet envisage.

Equally concerning is the fact that IESBA has tasked itself with making key decisions about auditors who serve audit clients that are PIEs without knowing itself what constitutes a PIE and without due regard for the divergences between entities that may constitute PIEs in different jurisdictions. We are

Page 5 of 14 to the Comment Letter to the IESBA of 4 June 2020

concerned that this is likely to lead to a disproportionate impact on audits, especially in the SMP arena.

The IDW is also concerned that without very clear persuasive justification the stark differentiation between audit clients that are PIEs and those that are not will drive a wedge in the audit market. There is a distinct danger that more stringent fee constraints for audit clients that are PIEs may – over time – lead to a trickle-down effect, certainly as far as larger SMEs that are non-PIEs are concerned.

Liaison with the IAASB

There are two areas where we believe better liaison with the IAASB is appropriate.

It would be useful for auditors to have comprehensive guidance on their communications with those charged with governance in one place. Accordingly, ISA 260 might include more precision resulting from the proposed changes to the Code about their independence.

The auditor's report serves a distinct purpose, which is primarily to inform the readers of the auditor's opinion (and in specific cases also about key audit matters) in the context of the respective responsibilities of management and the auditor. The auditor's report is not intended as a "collection point" for all types of peripheral information on a "nice to have" basis, because this would detract from its primary purpose.

Notwithstanding the fact that EU law requires this disclosure, in our view, the proposal to include this globally constitutes a misuse of the auditor's report for purposes other than for which it is generally intended. The proposal to potentially include disclosure of fee-related information in the auditor's report also requires the acceptance of such disclosures in the auditor's report by the IAASB: This is not a matter that the IESBA can decide without reference to the IAASB.

Page 6 of 14 to the Comment Letter to the IESBA of 4 June 2020

We would be pleased to provide you with further information if you have any additional questions about our response, or to discuss our views with you.

Yours truly,

Melanie Sack
Executive Director

Sebastian Kuck
Director, European Affairs

541/584

Appendix

Request for Specific Comments

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)?*

We understand this question as asking commenters whether they support IESBA's belief as stated in proposed para. 410.4.A1 with a yes or no answer. However, in our view, this issue is not a mere matter of belief, but requires further exploration.

We agree that there is some degree of inherent self-interest threat in the audit client payer model. However, as we discuss in the accompanying letter, we suggest that IESBA needs to recognize fully the impact of both the audit clients' corporate governance systems and adherence to professional standards and other requirements on reducing self-review threats to an acceptably low level. Thereafter IESBA should consider how to best to articulate its belief outlined in paragraph 23 of the Explanatory Memorandum and – after due deliberation – clarify that appropriate corporate governance measures regarding auditor engagement coupled with proper compliance with appropriate professional standards address this threat such that it does not exceed an acceptable level, such that a determination by the auditor is triggered by certain factors and not required in every engagement.

We agree that an intimidation threat to independence might be created when fees are negotiated with and paid by an audit client, and equally that this will not be the case in all audit circumstances.

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?*

Page 8 of 14 to the Comment Letter to the IESBA of 4 June 2020

We agree that a firm should be satisfied that threats to independence created by the fees proposed to an audit client are at an acceptable level in both situations a. and b. above.

However, we take issue with the proposed requirement for a firm to actively determine this in every engagement.

For the reasons explained in our accompanying letter and outlined in our response to q.1, we suggest IESBA debate further as to whether proper compliance with appropriate professional standards necessarily mitigates this threat such that it does not exceed an acceptable level.

This approach would obviate the need for firms to undertake an onerous determination (and documentation thereof) in all respect of audit engagements: such determination would instead be undertaken only when triggered by specific factors that – when present – would increase the level of threat. These factors are suitably outlined in the Code and proposed changes thereto.

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?*

Subject to our comments above concerning the need to require in all engagements a formal determination that the level of threat is acceptable, we agree that when a formal determination of the level of threats is triggered by specific factors that – when present – would increase the level of threat, mitigating factors such as those in proposed 410.4.A2. may be relevant.

In this context, whilst we agree that the existence of a quality management system in line with [proposed] ISQM 1 impacts the level of threat (proposed 410.4 A3), we question whether this is a separate factor in a firm's formal determination.

We support the inclusion of various examples of mitigating factors that may be encountered in practice (not, however, as “good practice” for all firms) as helpful to practitioners in firms of all sizes.

Page 9 of 14 to the Comment Letter to the IESBA of 4 June 2020

The IDW would not support IESBA including a firm's internal independent committee advising on governance matters as an example, on the basis that a few isolated jurisdictions now have such measures in place.

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?*

Yes. We support this requirement.

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:*
- Charged by both the firm and network firms to the audit client; and*
 - Delivered to related entities of the audit client?*

We are concerned with the proposed approach for several reasons. In our opinion, audit related services such as a review of an audit client's interim financial statements or services that are so closely related to the audit that generally the auditor would be the most appropriate party to provide such services do pose a self-interest threat to an auditor's independence. Indeed, it would be more appropriate to view audit-related services as a part of an auditor's overall service since every auditor would likely be the appropriate service provider merely because of being the auditor. In our view all audit related services should be clearly distinguished from other non-audit services.

Those of our members who are subject to the so-called fee cap under the EU Audit Regulation report problems in practice. Following a similar approach internationally would inevitably lead to similar issues.

The IESBA Code includes the following definitions:

“Network

A larger structure:

- That is aimed at co-operation; and*
- That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures,*

Page 10 of 14 to the Comment Letter to the IESBA of 4 June 2020

common business strategy, the use of a common brand-name, or a significant part of professional resources.

Network firm

A firm or entity that belongs to a network.”

We are not convinced that the services delivered by each and every network firm falling within this definition would impact the auditor's independence of appearance, let alone independence in mind. Any impact would vary according to the specific network arrangements as well as the relative proportion of the “large proportion” mentioned in proposed paragraph 410.10 A1 between the audit firm and the network firm(s). Should IESBA decide to retain the proposed reference to fees charged by network firm(s) it should decide and explain which of the factors (or combination of factors) in the definition cited above IESBA believes would impact auditor independence. We agree that the factor “clearly aimed at profit or cost sharing or shares common ownership” might indeed impact auditor independence, whereas we do not believe, for example, that the use of a common brand-name alone would do so.

Indeed, it may be difficult for an audit firm to obtain the necessary information from a widespread network that does not have common quality control policies and procedures. If the audit firm is unable to obtain information as to the level of threat, then such threat, if any, can only be in vague terms. In our view the perceptions of any such threat may often outweigh the actual threat.

Furthermore, when a fee is charged to related entities of an audit client any impact becomes more remote. To the extent that the auditor is unaware of any fees charged to related entities of the audit client there clearly can be no self-interest threat. The IESBA should weigh up the cost-benefit of including fees for services delivered to related entities, as we suggest no real threat would be created unless they are clearly known and to be of a certain magnitude.

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 appreciate the intention is not to preclude firms from entering different markets whilst growing their client bases.

Page 11 of 14 to the Comment Letter to the IESBA of 4 June 2020

Furthermore, the proposed 5 years reflect a purely arbitrary number plucked from decisions made in relation to PIE audit clients in jurisdictions such as the European Union, and conveys the message that compromised independence – if this is really the case in fact and not only in appearance – may be acceptable for the first few years, with time lessening this acceptability. In our view, this is merely in terms of perception.

For these reasons, we appreciate the intention, but do not believe proposing an exact threshold will be a workable solution for the non-PIE audit market globally.

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?

In practice the cost of an additional review will place smaller firms at a competitive disadvantage.

The “relief” intended in paragraph R410.16 by having another firm jointly involved in the audit may also increase costs (this has been one reason joint audits are not widely used unless mandated), and thus be equally disadvantageous.

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?

If IESBA does not support an outright ban for an auditor, we believe that involvement of the audit committee in any decision on such situations is an appropriate and sensible approach.

In practice, the cost of an additional review will place smaller firms at a competitive disadvantage.

The “relief” intended in paragraph R410.18 by having another firm jointly involved in the audit may also increase costs (this has been one reason joint audits are not widely used unless mandated), and thus be equally disadvantageous.

Page 12 of 14 to the Comment Letter to the IESBA of 4 June 2020

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 with this given the public interest connotations attaching to PIE audits.

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

Yes. However, in regard to proposed R410.20 (b) we refer to our response to q. 7.

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?*

Disclosure of audit fees is already required within the EU and is not an issue from the IDW's national perspective.

The auditor's report serves a distinct purpose, which is primarily to inform the readers of the auditor's opinion (and in specific cases also about key audit matters) in the context of the respective responsibilities of management and the auditor. The auditor's report is not intended as a "collection point" for all types of peripheral information on a "nice to have" basis, because this would detract from its primary purpose.

Notwithstanding the fact that EU law requires this disclosure, in our view, the proposal to include this globally constitutes a misuse of the auditor's report for purposes other than for which it is generally intended. The proposal to potentially include disclosure of fee-related information in the auditor's report also requires the acceptance of such disclosures in the auditor's report by the IAASB: This is not a matter that the IESBA can decide without reference to the IAASB.

Consequently, we are concerned at the proposed guidance in 410.25 A4, as we do not believe the IESBA has a mandate to make proposals affecting the content of the auditor's report.

Page 13 of 14 to the Comment Letter to the IESBA of 4 June 2020

In this context, we also refer to our response to q. 5, as we do not believe that including fees for services to related entities supplied by network firms is appropriate. The group auditor is not affected by any self-interest threat in such tenuous relationships, especially when unaware thereof.

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?*

Auditors of PIEs in the EU publish transparency reports. This is not an issue from the IDW's national point of view.

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.*

To the extent that the proposed changes go beyond national law, and are detrimental to particular segments of the audit market, they could violate anti-trust or anti-competition laws. We have commented on certain issues that we believe may be detrimental to SMPs, for example. The Code may be problematical to the extent that the effect of the proposals is to make it effectively much more difficult for SMPs to perform work or accept certain engagements.

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?*

Page 14 of 14 to the Comment Letter to the IESBA of 4 June 2020

We do not understand the logic underlying proposed 905.10 A2. Why is this only relevant for assurance services other than audits and reviews?

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?

We have not identified a further need for conforming changes.