Disclosure of fees paid to auditors by listed issuers

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Introduction

FMA's mandate is to strengthen public confidence in New Zealand's financial markets, promote innovation and grow New Zealand's capital base. Our vision is to promote and facilitate the development of fair, efficient, and transparent financial markets and raise standards of good conduct, ethics and integrity amongst market participants to ensure a regulatory environment in which investors can participate with confidence[1].

FMA monitors offer documents and financial statements for compliance with relevant laws. We also review offer documents on a risk basis immediately after their registration, as part of our post-registration process.

Through these reviews we became concerned that disclosures of fees paid to the external auditor[2] were unclear and that there was a lack of consistency in the disclosures. Our concerns were heightened where fees for other non-audit services were high relative to fees for the audit or review of the financial statements, and by unclear disclosure. As this is an important disclosure considered by users of financial statements we decided to carry out a thematic review of audit and non-audit fees.

As part of our thematic review, we reviewed the disclosure of fees paid to the external auditors of a sample of listed issuers for balance dates in 2012. This report summarises our findings and the concerns we have about the current quality of disclosure of audit and non-audit fees.

In this report, FMA does not form a view on the appropriateness of the fees paid or whether the fees impact on auditor independence. However, we think that in some cases the financial statements of issuers who are paying their auditor high fees for non-audit services would benefit from clearer disclosures regarding the other services provided. Users of the financial statements need a clear picture of how the external auditor's independence is managed by the issuer and how the auditor maintains its independence. FMA continues to encourage issuers to provide better disclosure of material items.

The audit committee of the issuer plays a key role in overseeing the audit process and in ensuring the independence of the auditor is preserved. In many cases we saw detailed disclosures in the annual report which highlighted the process the audit committee followed in managing the relationship with their auditor. In our view, this disclosure is beneficial for users of the financial statements to tie in the disclosure of fees paid to the external auditor with the process of maintaining independence.

[1] FMA *Statement of Intent 2013-2016* page 12.

[2] In this report where we use the term 'external auditor' we are referring to the auditor that undertakes the statutory audit of an entity, that is the audit required by Section 15 of the Financial Reporting Act 1993.

Data used in this review

FMA reviewed publicly available information in the financial statements of a sample of entities listed on the NZX from 2008-2012. Our review focused on the fees paid to the external auditor for the audit of the financial statements and fees for other services, and the way in which these fees were disclosed or presented in the financial statements.

Inconsistencies
It is not always clear whether the 'audit related services' are part of the statutory audit or part of other services. We expect that if 'audit related services' were part of the statutory audit they would have been disclosed as part of the audit fee. Therefore, in the data reviewed and presented in this report, we have used the fee for the audit or review of the financial statements as it was classified in the financial statements and all other fees have been included as fees for 'other services'. In doing this we note that due to inconsistencies in disclosure it is often difficult to determine which fees are for the audit or review of the financial statements and which fees are for other services. In this review, FMA has not made any adjustment for the inconsistencies.

These other services include, but are not limited to, financial reporting and advisory, tax planning, compliance and advisory, due diligence on transactions, information technology and many others.

Disclosures in financial statements

Disclosure requirements

Section 211 (1)(j) of the Companies Act 1993 and Financial Reporting Standard 44 *New Zealand Additional Disclosures* (FRS 44) require the disclosure of fees paid to the auditor in the annual report. FRS 44 (paragraphs 8.1 and 8.2) states:

> *"8.1: An entity shall disclose fees to each auditor or reviewer, including any network firm, separately for:*
>
> *a) the audit or review of the financial statements; and*
>
> *b) all other services performed during the reporting period.*
>
> *8.2: For 8.1(b) above, an entity shall describe the nature of other services."*

This disclosure has been required for accounting periods beginning on or after 1 July 2011.

Prior to the disclosure requirements in FRS 44 the requirement to disclose audit and other fees paid to the external auditor was in NZ IAS 1 paragraph NZ 105.1. Disclosure was required across the four broad categories of audit fees, audit related fees, tax fees and all other fees.

FMA's observations

Our review has highlighted that there are differences in how issuers are disclosing the fees paid to the auditor for the audit or review of financial statements and the non-audit fees paid to their auditor. These differences make it difficult for users of the financial statements to accurately assess the level of fees paid by the issuer for other services provided by the external auditor. We are concerned that this does not paint a clear picture for users of financial statements.

Some issuers provide fee information disclosure in a number of categories, for example, audit fees, other audit related services and other assurance services. While differentiating fees paid into different classes can provide useful information, it is not useful when the categorisations used are such that it becomes unclear what the fee paid for the audit or review of financial statements is. This occurs when the description of fees is so general in nature that it becomes difficult to determine whether fees included in one category should fall under the disclosure requirement of either FRS 44 paragraph 8.1(a) or 8.1(b). In some instances the information provided to meet the requirement of FRS 44 paragraph 8.1(a) appeared to include more than just the fee for the audit or review of the financial statements which suggested to us that the requirements of FRS 44 were not met.

An example of this type of disclosure is included in Table 1 below to illustrate:

Table 1

Fees paid to auditor:	**2013**	**2012**
	$'000	**$'000**
Audit of financial statements and other audit work	600	580
Audit related services	20	15
Tax compliance	85	75
Other services	15	55
	720	725

In the example above, it is not clear that the $600,000 disclosed for 'Audit of financial statements and other audit work' is solely for the audit or review of the financial statements. Similarly, it is not clear what the 'audit related services' relate to. In our view, this disclosure could be improved by clearly stating the fee for the audit or review of financial statements and showing separately the fees for other services performed during the period together with a description of those services. In many cases where an 'other services' or similar category was used, there was no explanation of what services those fees covered. This description is required by FRS 44, paragraph 8.2 and it is important for a user of the financial statements to understand what those fees consist of.

In Table 2 below, we have amended the example shown in Table 1 so that it better meets the requirements of FRS 44.

Table 2

Fees paid to auditor:	**2013 $'000**	**2012 $'000**
Audit of financial statements		
Audit and review of financial statements (note 1)	540	525
Other services		
Regulatory audit work (note 2)	60	55
Other assurance services (note 3)	20	15
Tax services (note 4)	85	75
Other services (note 5)	15	55
Total other services	180	200
Total fees paid to auditor	720	725

Notes:

1. The audit fee includes the fees for both the annual audit of the financial statements and the review of the interim financial statements.
2. Regulatory audit work consists of the audit of regulatory disclosures.
3. Other assurance services comprise reporting on trust deed requirements.
4. Tax services relate to tax compliance work.
5. Other services in 2013 comprise an agreed upon procedures engagement. In 2012 this fee was for due diligence work on the acquisition of a new subsidiary.

In Table 2, the fee for the audit or review of the financial statements is clearly and unambiguously disclosed. All other fees have been categorised into 'Other services' and an explanation of the breakdown of these services has been provided in the notes. FMA notes that there are other ways of disclosing the same information, so issuers may find an alternative method that achieves the same objective.

In our view, FRS 44 has not been consistently applied. In some cases the fees paid for other audit or assurance work have been bundled together with the fee for the statutory audit and in other cases the fee for the review of interim financial statements has not been included in the audit or review of financial statements line. We expect listed issuers to provide clear and concise disclosure of fees paid for audit and other services that at a bare minimum complies with FRS 44. Our expectation is that not only will the audit fee be clearly disclosed and only include the fee for the audit of the financial statements and the interim review, but that issuers will go a step further and as best practice clearly distinguish the other services into subcategories such as those disclosed in Table 2. In reviewing the data for our report, we chose not to include a table showing the split between audit and fees for other services for each issuer due to the inconsistencies in disclosure noted. This meant that the data was not consistent between issuers and would be difficult for users to interpret. In our future reviews of this fee data, fees will be reported by FMA as disclosed by issuers as audit or as fees for other services. Compliance with our guidance above is encouraged and we expect to be able to analyse fees across the different types of service area as shown in Table 2.

Issuers need to ensure that they have correctly applied the requirements of FRS 44 in disclosing audit and fees for other services and our preference is to use a similar format to that in Table 2.

We encourage issuers to include enhanced disclosures in the annual report, where relevant, of their policy in ensuring the auditor's independence is maintained when both audit and other services are being provided.

We have seen some good disclosure of audit and non-audit fees which clearly classifies the fees paid to the auditor between audit and other services, and includes an explanation of the other fees. Better disclosure also included additional disclosure in the annual report about the process the Audit Committee followed to ensure the independence of the external auditor was maintained. FMA would like to see other issuers adopt this approach.

Independence disclosures in the audit report

The external auditor is required[3] to make a statement in the audit report as to the existence of any relationship (other than that of auditor) which the auditor has with, or any interests which the auditor has in, the entity being audited. We note that some auditors take this a step further and make additional statements about their independence, specifically stating that these services had not impaired their independence as auditor of the company and group. We encourage this practice.

Role of the audit committee

Audit committees, external auditors and management work together to provide accurate and meaningful financial information. Audit committees play a critical role in overseeing the integrity of that financial reporting and ensuring the auditor's independence is preserved.

In many cases we saw detailed disclosures in the annual report which highlighted the process the audit committee followed in managing the relationship with their auditor. The types of disclosures seen included an explanation of the audit committee's policies in appointing and re-appointing the auditor, how the external auditor's independence is reviewed by the committee and the policy of approval of other non-audit services.

In our view, this type of disclosure is beneficial for users of the financial statements to understand the process the audit committee follows in managing the relationship with the external auditor and to tie in the disclosure of fees paid to the external auditor in the financial statements with the process of maintaining independence.

We encourage audit committees of all listed issuers to consider including such disclosures in their annual report.

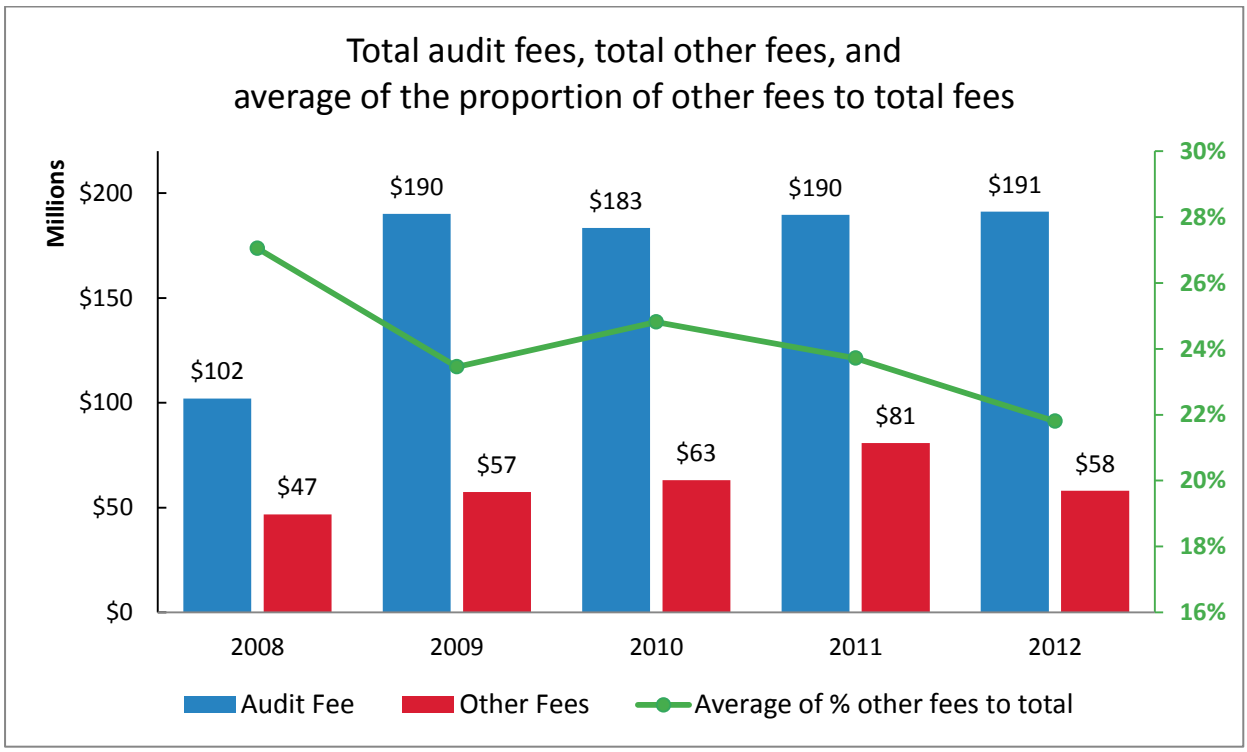
[3] Forming an Opinion and Reporting on Financial Statements (ISA(NZ) 700) paragraph NZ 33.1.

Analysis of Fees

Our review involved analysing the disclosure of audit and other fees paid to the external auditor as well as the level of audit fees compared to other services provided by the audit firm. Due to the inconsistencies in fee disclosures noted earlier in this report, it was difficult to get an accurate picture of the split of fees for audit of the financial statements and fees for other services. However, we are able to draw some general conclusions about trends in fees paid to the external auditor of listed issuers.

General trend of other fees

Graph 1[4]



In Graph 1, our population of listed issuers from 2008 to 2012 shows a general downward trend in the proportion of other fees to total fees. In 2008, on average other fees accounted for 27 percent of the total fees paid by issuers reviewed. By 2012 this dropped to 22 percent.

While fees for other services as a proportion of total fees has been falling over the last five years, the total value of other services increased over all years but the last. The drop in 2012 can be attributed to three

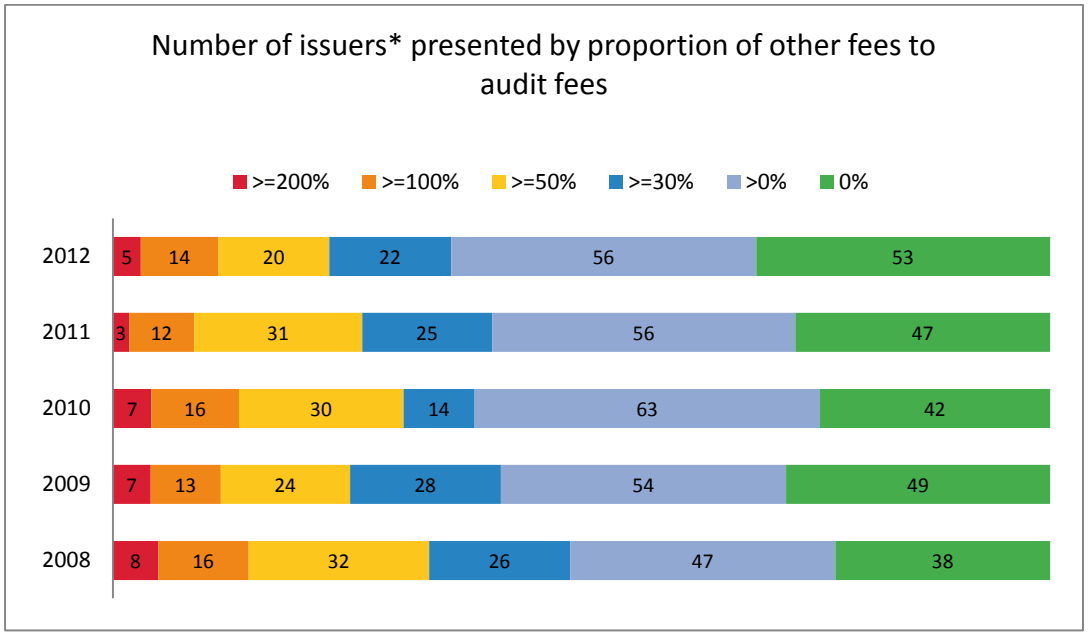
[4] Points to note about the data reviewed:

- Source data is provided to us by the NZX.
- All fees are in New Zealand dollars. For some issuers conversion to New Zealand dollars was required.
- Generally the same issuers are reviewed in each year.
- Graph 1 provides total audit fees and total other fees paid by the listed issuers reviewed to their external auditor or auditors (where multiple firms were used).
- Some of the listed issuers in the sample had external auditors that were not New Zealand audit firms. While a New Zealand audit firm may not have provided the other services, disclosure of fees is still important.

issuers for whom other fees dropped by $18.8 million and a further $1.6 million of the drop is due to issuers that delisted. We did note that 40 percent of the NZX listed issuers had a drop in fees for other services from 2011 to 2012.

A closer look at the 2012 year revealed that there are several issuers for whom fees paid to the external auditor for other services exceed the fees for the audit of financial statements. In this situation, it is of key importance that the disclosure regarding other fees is clear.

Graph 2



*Where the issuer had multiple auditors the data has been presented separately for each audit firm.

Graph 2 shows issuers by proportion of other fees to audit fees for each of the five years. Overall the number of listed issuers with auditors providing very high levels of other services is trending down from 24 issuers in 2008 to 19 issuers in 2012. A number of issuers had very high fees for other services over multiple years.

Conclusion

Our review has highlighted that disclosure by listed issuers of fees paid to the external auditor are often not in line with the requirements of FRS 44. Some of the current disclosures make it difficult for a user of the financial statements to determine the fees that relate to the audit of the financial statements and those paid for other services.

In a large number of the financial statements reviewed, the clarity of the amount paid to the auditor for the audit of financial statements and the descriptions of the nature of other services provided by the external auditor could be improved. We expect that all listed issuers will review and if necessary, improve their disclosure regarding external audit fees to fully comply with the requirements of FRS 44. Our view is that best practice in disclosing these fees requires the clear disclosure of the different types of other fees, in line with our example in Table 2.

Our review found that fees for other services relative to the total fee paid to external auditors is generally trending down, but there are a number of issuers where the fees for other services relative to the fee for audit services is high. We encourage all listed issuers to provide additional disclosures where the external auditor is engaged for other services. This is of significant use when the fees for other services are high relative to the audit fee. These additional disclosures should help a reader understand how the external auditor's independence is managed by the issuer and the audit firm, despite the provision of other services. A user of those financial statements would then have a more accurate perception of the external auditor's independence.

Investors depend on the integrity of financial information provided by the issuer and the integrity of the audit opinion provided by the auditor. FMA emphasises the significance of the audit committee's role in ensuring the integrity of that financial information and audit opinion. We encourage audit committees to continue to have rigorous and open discussions with their external auditors, and understand the critical processes and controls in place to maintain the independence of the external auditor. We also encourage audit committees to include disclosure in their annual report of the process the audit committee follows in managing the relationship with the external auditor. In FMA's view, this is of added importance when fees for non-audit services are high and provides useful information to investors.

FMA will continue to monitor the disclosure of audit and other fee information by issuers, and will be undertaking another review in the future to assess whether there has been improvement in these disclosures. While we did not publish data on the audit and non-audit fees in this report by issuer due to the inconsistent disclosure we encountered, our intention is to publish data showing the audit fee and the fees for other services analysed across different categories of non-audit services in future reports.

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