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BY FANN KOR AND KANG WAI GEAT

SHEDDING LIGHT ON AUDIT VS NON-AUDIT FEES

What Companies Must Know

MANY WERE SURPRISED BY WHAT HAPPENED RECENTLY AT COMFORTDELGRO'S ANNUAL GENERAL MEETING (AGM). Shareholders, under the recommendation of proxy advisors, voted against the reappointment of the auditor, Deloitte & Touche (Deloitte). The reason was that ComfortDelGro had paid Deloitte non-audit fees that exceeded 50% of its audit fees. The non-audit fees seemingly relate to initial public offering (IPO) work performed in Australia as publicly announced.

This incident has raised questions on non-audit fees and the 50% threshold.

WHAT ARE CONSIDERED NON-AUDIT SERVICES, AND WHY WOULD THE AUDITOR CARRY OUT THESE SERVICES?

Non-audit services are those which are not directly connected to an audit of financial statements, including the review of year-end and interim financial results announcements, and the certification work for submission

to parties such as government agencies (for grants) or landlords (for the variable component of some rental expenses which is dependent on revenue earned).

These non-audit services may be best performed by the auditor due to familiarity and knowledge. In an IPO listing of a company, audited financial statements for the three most recently completed financial years will be required in the IPO prospectus. From a risk management standpoint, to protect the interests of investors, the auditor is in the best position to be the reporting accountant of the IPO engagement. The company will usually appoint the auditor to be the reporting accountant.

IS 50% A GUIDELINE OR A RULE?

The other key issue is with the 50% threshold. It is important to know why 50% exists and what it means.

The ACRA Code of Professional Conduct and Ethics for Public



Accountants does not prohibit non-audit fees from exceeding 50% of the audit fees. What this means is, if the amount of annual fees received for non-audit services compared to the total annual audit fees from a listed audit client is 50% or more, the auditor shall disclose this to those charged with governance (TCWG) of the audit client. They shall also discuss the safeguards which will be applied to reduce any threats to auditor independence to an acceptable level.

In essence, the 50% marker exists to address a situation where, if non-audit fees exceed audit fees, the auditor may be pressured to sign off the audit opinion on the financial statements for fear of losing the client due to the size of the fees. If the 50% is crossed, the auditor will need to disclose and discuss with TCWG, who are usually the audit committees. This, however, does not mean that auditor independence has been impaired.

The 50% is set as a guideline rather than a rule.

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HOW CRITICAL ARE PUBLIC PERCEPTIONS AND EXPECTATIONS OF AUDITOR INDEPENDENCE?

Auditor independence is a topic under constant scrutiny due to the potential impact on the quality of audit work carried out by the auditor. It is understandable that shareholders will have concerns if the 50% guideline is exceeded. It is also reasonable for them to expect to be informed so that their concerns will be allayed.

To uphold corporate governance and better manage investor relations, companies should provide sufficient information clearly so that shareholders can better appreciate the issue at hand and how it has been addressed. Companies should do so even if such disclosures are not required by regulations. For a topic as



significant as auditor independence, it pays to “over communicate” and to say more, rather than less.

Furthermore, companies can include more specific disclosures and narratives in the relevant sections of their annual reports,

such as adding a note to the financial statements. Such tailored disclosures will allow readers of financial statements to understand that proper safeguards have been put in place and that auditor independence has not been impaired.

ASK QUESTIONS, GET ANSWERS

Auditor independence is integral to any financial reporting ecosystem and must be preserved to protect the interests of shareholders. If shareholders think that auditor independence may have been compromised, they have the right to raise questions and be given answers. The AGM is the perfect platform for shareholders to raise such questions to the Board of Directors. Companies must also be given the opportunity to explain their side of the story to the shareholders. Such question-and-answer will enable shareholders to assess the issue and make their judgements on the independence of their auditors.

Ultimately, the availability of more relevant information will frame issues in the right perspective and result in more informed decision making, for the benefit of all parties. ISCA

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