

Audit Fee and Independence Case Study

Auditors Penny & Pound is a second tier auditing firm with offices around the country. They have listed clients in their portfolio and recently started to expand their service offering into many other areas of client activities. These services are complimentary and meet the needs of current and future clients. They are:

- Corporate Governance in all its aspects
- IT related consulting
- HR consulting and placement services

These new activities are contained in a network firm. The partners of P&P decided that they would offer reduced audit fees to achieve the following:

- Generate additional work for the new activities
- Close a work load gap that existed during the period April 2014 to June 2014, resulting from the recent loss of a client.

The firm normally ensures to obtain a recovery rate of 80%, but now has made a conscious decision to reduce this rate to 65% for a period of time. The financial effects have been checked out and the firm believes it will obtain additional work because of the lower recovery. A time frame of about year has been agreed upon.

Shortly thereafter, P&P is approached to make a bid for the audit of Fairplay Limited, quoted on the Johannesburg Stock Exchange. Fairplay made it clear that they are unhappy with the incumbent auditors, as their fees are perceived to be too high. The fees for the last audit in 2013 amounted to R1.2 million.

P&P prepares an assessment of the engagement, taking into account the factors listed above and arrives at a similar fee of R1.3 million, but also identifying opportunities where a reduced fee would be appropriate. In line with their recently adopted approach to determining fees they agree that they will offer to do the audit for R845 000, a 65% budgeted recovery rate. They anticipate that they can obtain an IT contract from this new client, which will easily make up for lost earnings.

1. Is such action in compliance with the Code?
2. What threats are identified that could lead to P&P not being able to comply with the fundamental principles of the Code and compromise their independence?
3. What measures could be taken so that a reasonable third party, considering all the facts and circumstances, would agree that the safeguard put in place by P&P are sufficient to reduce any threat to an acceptable level?