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## A GUIDE TO CHARGING FOR PROFESSIONAL ASSURANCE SERVICES

### 1.0 INTRODUCTION

This Guide describes the basis for charging professional assurance services. It acts as a benchmark to establish a reasonable level of remuneration, commensurate with the provision of professional assurance services of an acceptable and recognized standard. As it constitutes part of generally accepted best practice in Malaysia, it is therefore recommended that professional accountants in public practice apply this Guide (RPG 7) in the performance of and charging for their respective duties.

### 2.0 CHARGING CLIENTS

2.1 Before undertaking any work on behalf of a new client, a professional accountant in public practice should ensure that the client is aware of the basis on which fees will be charged and how expenses incurred on behalf of the client will be treated. It will usually be appropriate to set these matters out in the Letter of Engagement upon accepting a new client.

2.2 There are two bases for computation of fee, i.e. Time-based and Value-based.

#### Time-based Principle

2.3 Time-based billing had been very useful in the past in assisting the practitioners in charging the clients. However, this method of computing professional fee had its flaws, namely:

- a. Arbitrary fixing of Charge-out Rate; the erroneous recording of Time Sheet and the provision of non-assurance advice given in the course of providing the assurance service.
- b. The differences in fixing Charge-out Rate between practitioners give rise to accusation of 'fee under-cutting'.
- c. Fixing of artificially low Charge-out Rate and erroneous Time Sheet result in undervaluing professional fees being billed to the clients.
- d. Time-based billing pre-supposes all information and knowledge is of equal value to all clients. It also discounted the value of research needed to satisfactorily discharge an assignment and the knowledge accumulated by the firm.

2.4 As an alternative to Time-based billing, the Institute advises the practitioners to consider Value-based billing.

#### Value-based Principle

2.5 The computation of an appropriate fee for services involves value judgment. It should take into account the value of advice rendered by the practitioner and the benefit, tangible and intangible, derived by the client.

2.6 Value-based billing takes cognizance of the knowledge and skills that a practitioner brought to bear on the assignment and the professional judgment that he was called upon to make. At the same time, the client who derived a certain value, be it functional value or emotional value, must be reflected by a fair and equitable fee payable.

2.7 In the course of applying Value-based billing, a practitioner must uncover the value drivers of his service. Value drivers are those elements that assist the practitioner in satisfactorily and professionally discharging his professional obligation. Generally, express and tacit knowledge,

information technology hardware, quality of internal processes and others can and are the drivers of value.

2.8 In the course of his professional work, the practitioner should and must impress upon his client the 'value' that is being 'delivered' and the 'value-drivers' that have been brought to bear in satisfying the client's objective.

#### Acceptable Practices

2.9 When entering into negotiations regarding professional services, a practitioner may quote whatever fee deemed to be appropriate. The fact that one practitioner may quote a fee lower than another is not in itself unethical. Practitioners must take cognizance of the provision of the Institute's By-Law 240. However, practitioners should take note that 'fee under-cutting' will bring disrepute to the profession as a whole.

2.10 Fees charged for assurance engagements should be a fair reflection of the value to the client and should take into account, inter alia:

- (a) the skill and knowledge required for the type of work involved;
- (b) the level of training and experience of the persons necessarily engaged on the work;
- (c) the time necessarily occupied by each person engaged on the work; and
- (d) the degree of responsibility and urgency that the work entails.

*(By-Laws Section 240.2A)*

2.11 The Institute encourages all practitioners to adopt Value-based billing. However, the Institute also recognizes that practitioners may encounter some difficulties in their negotiation with the clients. Hence, further guidance is provided under Section 4 of this RPG for practitioners' reference.

### **3.0 FEE DISPUTES**

3.1 Fee arrangements are a matter for commercial negotiation by the practitioners. Steps should be taken, so far as possible, to avoid disputes with clients over fees. A little foresight can often avoid a dispute and a number of suggestions to achieve this through regular CPE programme have been disseminated over the years. However, if a client does consider the amount of a bill to be excessive, an attempt should normally be made to settle the difference by negotiation. Court action should be considered as a last resort.

3.2 If a client who disputes a bill offers to pay a smaller sum on account, the amount tendered may be accepted without disadvantage provided it is made clear to the client at the time of acceptance, preferably in writing, that it is accepted as part payment only and not in full settlement.

3.3 Practitioners' attention is drawn to *By-Laws Section 530* which deals with liens in respect of unpaid fees should such issues arise.

**3.4 It should be noted that the Institute will not arbitrate between a practitioner and his client upon the amount of a disputed fee.**

### **4.0 RECOMMENDED GUIDE TO USING AUDIT FEE COEFFICIENT COMPUTATION**

#### 4.1 Background Information

The scale of fees contained under the old Recommended Practice Guide 7 was first drawn up in 1994. Since then, no revision has been made. These fees form the basis of audit charges for statutory audit in Malaysia.

In light of significant regulatory and auditing standards developments, and a shift in the expectations of those charged with governance and other stakeholders, the Public Practice Committee initiated a review of the existing manner of calculating scale of fees to better reflect on current operating conditions. The revision proposed herein is deemed to be fair and reasonable having taken into account the current market condition and consultation with fellow members.

**The Public Practice Committee is of the opinion that professional fee should be charged using VALUE delivered principle rather than TIME expended. The suggested audit fee coefficient computation should be used as a last resort and as guidance only, when practitioners encounter difficulty in arriving at a satisfactory fee amount using the value based billing method.**

This revised Recommended Practice Guide is effective on and after 1 March 2010.

#### 4.2 Rationale for the Revision

##### 4.2.1 Increase in Compliance Burden due to Higher Auditing Standards Requirements

In the wake of several corporate failures, significant changes have occurred in the audit arena. In that, the profession is no longer self-regulated, new inspection regimes have evolved and auditing standards have been given the full force of law.

Malaysia has taken various measures, including the need for member firms to observe the minimum standards in the auditing of individual engagement as well as to comply with the firm-wide International Standards on Quality Control (ISQC) 1. As auditing standards become more detailed and more complex, the resulting costs of audits naturally increases.

These standards were devised primarily with large entities in mind, yet many audits are performed for small and medium sized entities (SMEs). This level of rigor significantly increases the costs and time spent on each audit.

##### 4.2.2 Increase in Operating Costs Over the Years

Over the past few years, the operating costs of an audit firm have increased tremendously due to:

- i) Regulatory changes that increase the auditing standards and compliance burden;
- ii) Inflationary effects on staff, staff training, IT infrastructure and general administrative costs;
- iii) Substantial litigation arising from non-compliance / negligence

The Institute is of the view that with the revised RPG 7, the accounting profession can be developed in a more orderly manner. Proper regards to the firm's investment in training and technology can be more sustainable and in the long run, it should be beneficial to the industry as a whole.

### 4.3 Suggested Billing Methodology

#### 4.3.1 Audit Charge-Out Rates

(A) Introduction:

Time management is essential in ensuring efficiency in audit performance while time recording is an integral part of the documentary evidence of work performed.

Time charge shall be reflective of time spent by the partner and staff in terms of the quality and level of competence required to meet the auditing standards with reference to the size, complexity and technical input expected of the audit assignments.

A critical factor in maintaining the viability of a practice depends on good costing.

The determination of charge-out rate is costing for audit practice.

In the absence of a uniform basis, charge-out rates may differ due to inadequate or over computation of the variable cost factors.

The Council therefore recommends the basis for time charging as set out below. From past experience, cost computation based on the recommended basis will normally produce a factor of about **3 (three)** times the direct labour cost.

(B) Definitions

(i) "Economic time charge" shall include the following :

Labour Cost

Opportunity Cost, equivalent to the direct labour recovery cost of each staff

Appropriate Recovery of Overheads

Profit Element

(ii) The unit rate should be based on net working hours.

Net working hours:

Total chargeable hours based on normal working days in the year of a practice net of annual holidays, annual leave, study and examination leave and firm's holidays.

(iii) Total Labour Cost :

Actual Wage, including EPF and Socso Contribution

Training Cost, including course and examination fees

Cost of Study Leave

Gratuities

Welfare Cost

(iv) Overheads Recovery Rate:

Practitioners may wish to adopt the absorption method which will take into account the total net working hours of the practice. However, it may not be appropriate because the recoverability rate of each member of staff differs. An alternative is to derive the weighted average based on estimated

administrative time of each grade of staff. The administrative time of each staff can be determined with reasonable accuracy from the time sheets submitted by each staff over a control period.

(C) Basis

Charge-out Rates shall be computed on the basis of economic time charge and should reflect its recoverability. It should include direct cost and also an appropriate proportion of fixed overheads.

(D) Calculation of Charge-out Rate

	<b>RM</b>	
Direct Labour Recovery Rate represented by	<u>Total Labour Cost</u>	XX
	Net Working Hours	
Add		
Opportunity cost (represented by Direct Labour Recovery Rate*)		XX
Add		
Overhead Recovery Rate		XX
Add		
Profit Element		<u>XX</u>
Charge-out Rate		<u>XX</u>

\* The element of Direct Labour Recovery Rate is effectively doubled in the calculation of Charge-out Rate.

**4.3.2 Benchmark in Assisting Practitioners to Extrapolate Audit Fees (Recommended Basis Only)**

(A) Introduction

Audit fees shall generally be based upon the degree of responsibility, risk and skill involved and the time necessarily occupied on the work.

Past empirical studies carried out by the Institute have shown a proportionate correlation between audit fees charged, based on time charge, and the value of total assets or gross turnover or operating expenditure. Therefore, for consistency and harmonisation of the fee levels, Council recommends that it is appropriate to determine audit fees using the Total Assets or Gross Turnover as shown in the financial statements and multiplying it with the coefficient percentages as shown in the coefficient percentage table (under Paragraph 4.3.3).

The choice of Gross Turnover or Total Assets as the basis must be relevant and reflects closely to the time charge. Only where it is not appropriate to use Total Assets or Gross Turnover, members may adopt Total Operating Expenditure basis which must be relevant and reflect closely on time charge.

(B) Definitions

- (i) "Total Assets" is defined as the total of all assets as shown in the Balance Sheet.
- (ii) "Gross Turnover" shall mean and include:
  - (a) Total amount of sales including all other income and earnings for the year in the case of all manufacturing and trading organisations;
  - (b) Total gross premium income including all other income and earnings for the year in the case of all insurance organisations;
  - (c) Total amount of interest, discount, commission, exchange brokerage and all other income and earnings for the year in the case of banks and other financial institutions;
  - (d) Total amount of commission including all other income and earnings for the year in the case of travel agencies, indentors, brokers and other organisations whose principal source of income is commission earnings; and
  - (e) Total receipts/bills accounted for and all other income and earnings for the year in the case of construction companies and other entities not covered under (a) to (d) above.
- (iii) "Total Operating Expenditure" includes all expenses charged against gross profit to arrive at net profit before tax but excludes direct cost of sales.

(C) Computation Examples

Example 1

Assume that the Gross Turnover is RM1,740,000 and its Total Assets amount to RM2,560,000. The audit fees based on Total Assets and Gross Turnover will be computed as follows:-

On Total Assets:

					<b>RM</b>
First	100,000	at 1.000%	=		1,000
Next	150,000	at 0.438%	=		657
Next	250,000	at 0.313%	=		783
Next	500,000	at 0.188%	=		940
Next	1,500,000	at 0.125%	=		1,875
Next	60,000	at 0.100%	=		60
<b>Total</b>	<b>RM2,560,000</b>				<b>RM5,315</b>

On Gross Turnover:

First	100,000	at 1.000%	=	1,000
Next	150,000	at 0.438%	=	657
Next	250,000	at 0.313%	=	783
Next	500,000	at 0.188%	=	940
Next	740,000	at 0.125%	=	925
<b>Total</b>	<b>RM1,740,000</b>			<b>RM4,305</b>

However, the above determination must always be matched against time charge. Therefore, different jobs with different business activities and business structure may have the same Total Assets and Gross Turnover but the time incurred in performing the audit may vary.

For comparison purposes, if we use the above figures that has the same gross turnover and total assets but with different time charge for different companies' audit, as follows:-

Company 1 – RM4,000

Company 2 – RM4,750

Company 3 – RM5,000

Company 4 – RM6,000

The audit fees shall be determined as follows:

For Company 1

Time Charge is relevant and closer to fees computed based on Gross Turnover. Thus, the recommended fee of RM4,305 will apply.

For Company 2

Time Charge is between fees computed based on Total Assets and Gross Turnover. Thus the recommended fee will be based on time charge at RM4,750.

For Company 3

Time Charge is relevant and closer to fees computed based on Total Assets. Therefore, the recommended fee will be RM5,315.

For Company 4

Time Charge is higher than the fee calculated based on Total Assets. Therefore, the recommended fee will be on time charge at RM6,000.

Example 2

In a situation where an organisation has a Turnover of RM100 million and Total Assets of RM5,000 with total operating expenditure of RM1.5 million, it will be inappropriate to determine audit fees using the Total Assets or Gross Turnover basis because of the extremes.

Therefore, it will be appropriate to use Total Operating Expenditure.

Based on Total Operating Expenditure of RM1.5 million, the fee computed per the coefficient percentage table will be RM9,375 as follows :

				RM
The first	50,000	at 2.500%	=	1,250
The next	150,000	at 1.250%	=	1,875
The next	800,000	at 0.625%	=	5,000
The next	500,000	at 0.250%	=	1,250
<b>Total</b>	<b>RM1,500,00</b>			<b>RM9,375</b>

Again, this figure as computed will be compared against the time charges incurred to determine whichever is higher.

#### (D) Procedures for Implementing the Change in Audit Fees Billing

- (i) The revised recommended levels of audit fees shall be applicable in respect of all statutory audits of companies registered under the Companies Act, 1965.
- (ii) The recommended levels of audit fees are applicable only for draft accounts submitted for audit with proper schedules. Practitioners may wish to charge higher audit fees having considered the reliance placed on internal control, complexity of business activity, volume of transactions, degree of responsibility and risk, skill of staff and timing of the audit etc.
- (iii) Draft accounts submitted without proper schedules would require a member firm to utilise more skill and knowledge as well as time spent on the assignment, and as such the member firm should advise the client that higher audit fees shall be charged for such audit assignments, issue of independence notwithstanding.

#### 4.3.3 Coefficient Percentage Table

- (i) Gross Turnover or Total Assets Basis

Gross Assets or Turnover for every ringgit of		Rate(%)
<b>RM</b>		
The first	100,000	1.000
The next	150,000	0.438
The next	250,000	0.313
The next	500,000	0.188
The next	1,500,000	0.125
The next	2,500,000	0.100
The next	5,000,000	0.094
<u>The next</u>	<u>10,000,000 to 20,000,000</u>	<u>RM1,000 for every RM1,000,000 increase or a fraction thereof up to RM20 million*</u>
<u>Above</u>	<u>20,000,000</u>	<u>Negotiable (but should not be less than RM20,000 per assignment)</u>

\* The diminishing scale should not apply here due to clients' probable complexity and at the same time a capping is deemed appropriate.

(ii) Total Operating Expenditure Basis

Total Operating Expenditure for every ringgit of		Rate (%)
<b>RM</b>		
The first	50,000	2.500
The next	150,000	1.250
The next	800,000	0.625
The next	1,000,000	0.250
Above	2,000,000	0.125

#### 4.4 Minimum Fees for Dormant Company and the Co-efficient Scale

4.4.1 A professional fees of less than Ringgit Malaysia Eight Hundred (RM 800) for audit services shall be considered as an unrealistically low professional fees.

4.4.2 The Institute shall consider the possibility to increase the fee co-efficient scale by another 25% in two (2) years time.

## 5.0 FURTHER CONSIDERATIONS

Although the examples given are meant to be an illustration of how audit fees can be determined, practitioners are also reminded that the use of the benchmark computation is on the basis that the clients has submitted the draft accounts with ALL PROPER SCHEDULE to the auditors. Naturally, draft accounts submitted without proper schedule would require a member firm to utilise more skill and knowledge as well as time spent on the assignment (independence issue notwithstanding) and as such the member firm should advise the client that a higher audit fees shall be charged for such assignments.

Under paragraph 4.3.2, it was mentioned that the use of the fee computation coefficient to arrive at a benchmark fee must be compared with the time charge and whichever figure that is higher (after the comparison) should be the basis for billing to the client.

## 6.0 CONCLUDING REMARKS

Fee arrangement is a matter for commercial negotiation by practitioners. The Institute does not prescribe the mandatory basis for calculating fees, nor does it ordinarily investigate complaints relating solely to the quantum of fees charged.

The level of fee is to be mutually agreed between the auditor and his client which largely depends upon the skill and knowledge required, level of training and experience of the staff involved, the time necessarily occupied and the degree of responsibility and urgency of work involved.

However, this RPG is useful as a benchmark to establish the reasonable level of remuneration, commensurate with the provision of professional services of an acceptable and recognised standard in the absence of other more sophisticated billing methodology.

This revised Guide, published in March 2010, has taken into account the position of the Institute's By-Laws as at 1 March 2010. Professional accountants in public practice should always ensure that their knowledge of the By-Laws is up-to-date when quoting for fees.

For ease of comparison, two tables are worked out as follows:

### **Table 1: Main Amendments to the revised RPG 7**

Existing Guides	Revised Guides
A professional fee of less than Ringgit Malaysia <b>Five</b> Hundred (RM 500) for audit services shall be considered as an unrealistically low professional fee.	A professional fee of less than Ringgit Malaysia <b>Eight</b> Hundred (RM 800) for audit services shall be considered as an unrealistically low professional fee.

- The Fee co-efficient is to be increased by 25% with a possibility of increase by another 25% in 2 years time
  - The scale fees is expanded to cover companies with gross assets and turnover of up to RM 20 million. The fee increase is RM 1,000 for every turnover or gross asset band of RM 1 million or part thereof
- The Fee co-efficient is to be increased by 25% with a possibility of increase by another 25% in 2 years time
- The scale fees is expanded to cover companies with gross assets and turnover of up to RM 20 million. The fee increase is RM 1,000 for every turnover or gross asset band of RM 1 million or part thereof

**Table 2: Amendments to the Fee-coefficient Percentage Table**

Coefficient Percentage Table	Gross Assets or Turnover for every ringgit of	Existing Rate (%)	Revised Rate (%)
<b>(i) Gross Turnover or Total Assets Basis</b>	<b>RM</b>		
	The first 100,000	0.8	1.00
	The next 150,000	0.35	0.438
	The next 250,000	0.25	0.313
	The next 500,000	0.15	0.188
	The next 1,500,000	0.10	0.125
	The next 2,500,000	0.08	0.100
	The next 5,000,000	0.075	0.094
	10,000,000 to 20,000,000	Negotiable	RM 1,000 for every RM 1 million increase or a fraction thereof up to RM 20 million
	Above 20,000,000	Negotiable	Negotiable (but should not be less than RM 20,000 per assignment)
Coefficient Percentage Table	Total Operating Expenditure for every ringgit of	Existing Rate (%)	Revised Rate (%)
<b>(ii) Total Operating Expenditure Basis<sup>1</sup></b>	<b>RM</b>		
	The first 50,000	2	2.5
	The next 150,000	1	1.25
	The next 800,000	0.5	0.625
	The next 1,000,000	0.2	0.25
	Above 2,000,000	0.1	0.125

1 To be used in limited circumstances only.

(Extracted from Malaysian Institute of Accountants)