



Audit Committee Pre-Approval of Services

A GUIDE FOR AUDIT COMMITTEES



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Safeguarding Independence

At BDO, we are committed to providing the highest quality services and maintaining the professional standards expected from an accounting firm. BDO is also dedicated to upholding the highest standards of independence, ethics, and compliance in accordance with both internal policies and external laws and regulations.

As auditors and professional advisors, we are subject to a number of independence-related rules and regulations designed to protect the general public, our clients and our firm. These rules have been established by the federal government and its oversight bodies, including the Public Company Accounting Oversight Board (PCAOB) and the Securities and Exchange Commission (SEC), as well as other bodies, such as the American Institute of Certified Public Accountants (AICPA) and the International Ethics Standards Board for Professional Accountants (IESBA).

The SEC and PCAOB have both issued a number of statements making clear their belief that maintaining auditor independence is the responsibility of both a company and its auditor. In its October 16, 2020, rules release, *Qualifications of Accountants*, the SEC states, “*We remind auditors and their audit clients of their shared responsibility to monitor independence,*” and most recently, in the September 2024 Spotlight [*Inspection Observations Related to Auditor Independence*](#) (2024 PCAOB Spotlight), the PCAOB stated, “*Independence is a shared responsibility between the entity under audit, its audit committee, and its auditor.*”

Audit committees play an essential role in ensuring that the company is doing its part to safeguard independence and uphold the goal of providing high-quality, reliable financial information to the capital markets.

With that in mind, this guide addresses the SEC and PCAOB requirements for audit committees to pre-approve all services provided to the company by its auditor and suggests steps companies and their audit committees can take to strengthen this critical oversight responsibility.

Overview

The Sarbanes-Oxley Act of 2002 (SOX) mandates that audit committees be directly responsible for the engagement and oversight of the company's independent auditor. It also mandates that the SEC's rules be designed to ensure that auditors are independent of their audit clients.

In 2003, the SEC adopted rules to comply with the requirements of SOX. The audit committee-related rules require that before the auditor is engaged by the issuer or its subsidiaries to render permissible non-audit services and all audit, review, or attest engagements required under the securities laws, the engagement must be:

- ▶ Approved by the issuer's audit committee; or
- ▶ Entered into pursuant to pre-approval policies and procedures established by the audit committee of the issuer, provided the policies and procedures are detailed as to the particular service, the audit committee is informed of each service, and such policies and procedures do not include delegation of the audit committee's responsibilities to management.

Subsequently, the PCAOB adopted rules designed to supplement the SEC's pre-approval requirements specific to tax services and services related to internal control over financial reporting.

Given the importance of auditor independence, in 2023 the PCAOB increased its focus on certain independence requirements during its inspections of audit firms. One of the areas of added focus was compliance with these pre-approval requirements. In 2023, roughly one-third of all PCAOB comment forms issued during the inspections with this increased focus related to audit committee pre-approval.

In the 2024 PCAOB Spotlight referenced on page 3, the PCAOB highlighted some considerations for audit committees on their oversight responsibilities regarding their auditor's independence. Some of those considerations included:

- ▶ Audit committees are required to consider whether any services provided by the audit firm may impair the audit firm's independence in advance.
- ▶ Audit committees should be aware that certain financial relationships between the company and the independent auditor are prohibited.
- ▶ Audit committees should consider whether the public company's policies and procedures require that all audit and non-audit services are brought before the audit committee for pre-approval.
- ▶ Audit committees should not approve engagements that remunerate an independent auditor on a contingent fee or a commission basis, as such remuneration is considered to impair the auditor's independence.
- ▶ Audit committees should consider whether their auditor has implemented processes to identify prohibited relationships.
- ▶ Audit committees should discuss the following with the audit firm:
 - Processes the audit firm uses to ensure complete disclosure of all relationships with the public company and its affiliates.
 - Relationships the audit firm may have with officers, board members, and significant shareholders.
- ▶ If the audit committee pre-approves services using pre-approval policies and procedures, the audit committee should consider whether the pre-approval policies and procedures are sufficiently detailed as to the particular services to be provided so that the audit committee can make a well-reasoned assessment of the impact of the service on the auditor's independence.
- ▶ Independence is a shared responsibility among the entity under audit, its audit committee, and its auditor. It is important for the company to have policies and procedures to proactively alert auditors to proposed or pending merger and acquisition activity that could have an impact on auditor independence.

Specific Rules Related to Audit Committee Pre-Approval

There are three rules specifically related to audit committee pre-approval: one SEC rule and two PCAOB rules. These rules are as follows:

SEC Rule 2-01(c)(7) of Regulation S-X

(7) Audit committee administration of the engagement. An accountant is not independent of an issuer (as defined in section 10A(f) of the Securities Exchange Act of 1934, other than an issuer that is an Asset-Backed Issuer as defined in § 229.1101 of this chapter, or an investment company registered under section 8 of the Investment Company Act of 1940, other than a unit investment trust as defined by section 4(2) of the Investment Company Act of 1940), unless:

(i) In accordance with Section 10A(i) of the Securities Exchange Act of 1934 either:

- ▶ Before the accountant is engaged by the issuer or its subsidiaries, or the registered investment company or its subsidiaries, to render audit or non-audit services, the engagement is approved by the issuer's or registered investment company's audit committee; or
- ▶ The engagement to render the service is entered into pursuant to pre-approval policies and procedures established by the audit committee of the issuer or registered investment company, provided the policies and procedures are detailed as to the particular service and the audit committee is informed of each service and such policies and procedures do not include delegation of the audit committees responsibilities under the Securities Exchange Act of 1934 to management; or
- ▶ With respect to the provision of services other than audit, review or attest services the pre-approval requirement is waived if:
 - The aggregate amount of all such services provided constitutes no more than five percent of the total amount of revenues paid by the audit client to its accountant during the fiscal year in which the services are provided;
 - Such services were not recognized by the issuer or registered investment company at the time of the engagement to be non-audit services; and
 - Such services are promptly brought to the attention of the audit committee of the issuer or registered investment company and approved prior to the completion of the audit by the audit committee or by one or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.



PCAOB Rule 3524 Audit Committee Pre-approval of Certain Tax Services

In connection with seeking audit committee pre-approval to perform for an issuer audit client any permissible tax service, a registered public accounting firm shall:

- ▶ Describe, in writing, to the audit committee of the issuer:
 - The scope of the service, the fee structure for the engagement, and any side letter or other amendment to the engagement letter, or any other agreement (whether oral, written, or otherwise) between the firm and the audit client, relating to the service; and
 - Any compensation arrangement or other agreement, such as a referral agreement, a referral fee or fee-sharing arrangement, between the registered public accounting firm (or an affiliate of the firm) and any person (other than the audit client) with respect to the promoting, marketing, or recommending of a transaction covered by the service;
 - Discuss with the audit committee of the issuer the potential effects of the services on the independence of the firm; and
 - Document the substance of its discussion with the audit committee of the issuer.

In summary, the rules require that all audit and non-audit services to the company be pre-approved by the audit committee either directly or through policies and procedures adopted by the audit committee and, with respect to tax and internal control related services, a description of the services must be provided in writing and the auditor must specifically document discussions with the audit committee.

Note: The pre-approval requirements are only for the services and, in some cases, the fee structure for example, a fixed fee or rates/hours. The rules do not require that the audit committee pre-approve the specific dollar amount of the fees. In instances where fees are being negotiated but there is an urgency to begin the services, the audit committee should pre-approve the services based upon a written description of the agreed-upon services. The auditor can then begin services while the fees are finalized.

PCAOB Rule 3525 Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting

In connection with seeking audit committee pre-approval to perform for an issuer audit client any permissible non-audit service related to internal control over financial reporting, a registered public accounting firm must:

- ▶ Describe, in writing, to the audit committee of the issuer the scope of the service;
- ▶ Discuss with the audit committee of the issuer the potential effects of the service on the independence of the firm; and

Note: Independence requirements provide that an auditor is not independent of his or her audit client if the auditor is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the auditor is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. Several principles guide the application of this general standard, including whether the auditor assumes a management role or audits his or her own work. Therefore, an auditor would not be independent if, for example, management had delegated its responsibility for internal control over financial reporting to the auditor or if the auditor had designed or implemented the audit client's internal control over financial reporting.

- ▶ Document the substance of its discussion with the audit committee of the issuer.

Audit Committee Pre-Approval Policies and Procedures

Suggested policies and procedures for companies to put in place related to audit committee pre-approval include:

- ▶ Educate those individuals with the authority to engage external service providers so all are aware that when engaging with any BDO firms there are procedures that must be followed to determine that:
 - The requested services are permitted under the SEC/PCAOB independence rules (this should include consulting with the BDO audit engagement team as to the permissibility of the services);
 - Audit committee pre-approval is obtained by the audit engagement team prior to engaging and services beginning; and
 - All company policies and procedures related to audit committee pre-approval should include all subsidiaries, including those located internationally.
- ▶ The audit committee should communicate directly with the BDO audit engagement team. BDO cannot fully meet the standards' requirements if communication with the audit committee is mediated through a member of management. For instance, essential discussions about the independence implications of services, as mandated by PCAOB rules, must occur directly between the auditor and the audit committee, without management intermediation.
- ▶ Include documentation of audit committee discussion of the services and the related audit committee pre-approval in the minutes of the audit committee meetings.
- ▶ Consider delegating to one audit committee member (e.g., the Chair) the ability to pre-approve services on behalf of the entire committee. The entire committee can subsequently be informed of all services that were pre-approved. This can help streamline the pre-approval process and make it more timely. The delegation of such authority should be documented in the audit committee's charter.

The SEC rule permits for audit committee pre-approval to be accomplished through audit committee policies and procedures. Utilizing such policies and procedures could significantly streamline the process of audit committee pre-approval. The SEC does provide some guidance regarding pre-approval policies and procedures and their content.

The February 2003 SEC Rules Release, *Strengthening the Commissions Requirements Regarding Auditor Independence* states, "These rules require that the audit committee pre-approve all services. In doing so, the Act permits the audit committee to establish policies and procedures for pre-approval provided they are detailed as to the particular service and designed to safeguard the continued independence of the accountant. For example, the Sarbanes-Oxley Act allows for one or more audit committee members who are independent board directors to pre-approve the service. Decisions made by the designated audit committee members must be reported to the full audit committee at each of its scheduled meetings."

Additionally, the SEC has published the following FAQs related to audit committee pre-approval policies and procedures.¹

Question 3 (issued August 13, 2003)

Q: The Commission's rules require the audit committee to pre-approve all services provided by the independent auditor. In doing so, the audit committee can pre-approve services using pre-approval policies and procedures. Can the audit committee use monetary limits as the sole basis for establishing its pre-approval policies and procedures?

A: Monetary limits cannot be policies the sole basis for the pre-approval policies and procedures. The establishment of monetary limits would not, alone, constitute policies that are detailed as to the particular services to be provided and would not, alone, allow for the audit committee to be informed about each service.

The Commission's rules include three requirements that must be followed in the audit committee's use of pre-approval through policies and procedures. First, the policies and procedures must be detailed as to the particular services to be provided. Second, the audit committee must be informed about each service. Third, the policies and procedures cannot result in the delegation of the audit committee's authority to management. The Commission's rules require compliance with all three of these requirements.

Question 4 (issued August 13, 2003)

Q: Can the audit committee's pre-approval policies and procedures provide for broad, categorical approvals (e.g., tax compliance services)?

A: No. The Commission's rules require that the pre-approval policies be detailed as to the particular services to be provided. Use of broad, categorical approvals would not meet the requirement that the policies must be detailed as to the particular services to be provided.

Question 5 (issued August 13, 2003)

Q: How detailed do the pre-approval policies need to be?

A: The determination of the appropriate level of detail for the pre-approval policies will differ depending upon the facts and circumstances of the issuer. However, a key requirement is that the policies cannot result in a delegation of the audit committee's responsibility to management. As such, if a member of management is called upon to make a judgment as to whether a proposed service fits within the pre-approved services, then the pre-approval policy would not be sufficiently detailed as to the particular services to be provided. Similarly, pre-approval policies must be designed such that the audit committee knows what services it is being asked to pre-approve so that it can make a well-reasoned assessment of the impact of the service on the auditor's independence. For example, if the audit committee is presented with a schedule or cover sheet describing services to be pre-approved, that schedule or cover sheet must be accompanied by detailed back-up documentation regarding the specific services to be provided.

The audit committee should consider putting in place pre-approval policies and procedures where the audit committee believes it would be appropriate.

The following are examples of possible pre-approval policies and procedures that we believe **would be acceptable** based upon the guidance above:

- ▶ The audit committee pre-approves all services related to the preparation of required tax returns for the company or its subsidiaries — for example, state and federal income tax returns and returns required by international taxing authorities, such as VAT returns and GST returns, that have previously been pre-approved by the audit committee.
- ▶ The audit committee pre-approves all statutory audit services provided to non-domestic subsidiaries that have previously been pre-approved by the audit committee.

¹ See <https://www.sec.gov/about/divisions-offices/office-chief-accountant/office-chief-accountant-application-commissions#audit>

The following are examples of possible pre-approval policies and procedures that we do **not believe would be acceptable** based upon the guidance above:

- ▶ The audit committee pre-approves all tax consulting services. (Question 4 above states that the “use of broad, categorical approvals would not meet the requirement that the policies must be detailed as to the particular services to be provided.” In this instance there are many different kinds of services that could be provided so audit committee cannot know exactly what is being pre-approved.)
- ▶ The audit committee pre-approves all services with de-minimums fees. For purposes of this policy, that means fees under \$_____. (Question 3 above states, “Monetary limits cannot be policies the sole basis for the pre-approval policies and procedures.”)
- ▶ The audit committee pre-approves all of the following services:
 - All services related to the preparation of required tax returns for the company — for example, state and federal income tax returns and returns required by international taxing authorities such as VAT returns and GST returns.
 - The following tax consulting services: transfer pricing studies, R&D studies, 382 studies, and cost segregation studies. Additionally, services to provide tax advice on corporate structuring and tax impacts related to business combinations.
 - One-time assessments to review company processes, benchmark them against published standards or industry best practices and make recommendations for improvement.
 - Implementation of software that is unrelated to financial reporting processes, such as Microsoft Office (Word, Excel, PowerPoint etc.), marketing-related software, or software related to the preparation of tax returns.
 - Statutory audit services
 - SOC attestation services

(While this policy is very detailed as to the services being pre-approved, it includes almost every service that the audit firm is permitted to provide to an issuer audit client. Since there would be little to nothing that would ever require the auditor to come to the audit committee for pre-approval, the SEC would likely view this as the audit committee delegating its responsibility to management as discussed in question 5 above).



Conclusion

We would be happy to discuss with the audit committee any questions related to the audit committee pre-approval requirements and/or related best practices. We look forward to a strong working relationship with the audit committee and believe that together we can safeguard independence and fulfill our responsibilities to investors and other stakeholders.

Our purpose is helping people thrive, every day. Together, we are focused on delivering exceptional and sustainable outcomes and value for our people, our clients and our communities. BDO is proud to be an ESOP company, reflecting a culture that puts people first. BDO professionals provide assurance, tax and advisory services for a diverse range of clients across the U.S. and in over 160 countries through our global organization.

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