Standard

Audit and Assurance

Financial Reporting Council

June 2016

Revised Ethical Standard 2016

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

ETHICAL STANDARD (2016)

INTEGRITY, OBJECTIVITY AND INDEPENDENCE

Contents ***page***

Section 2 – Financial, Business, Employment and Personal Relationships

Section 3 – Long Association with Engagements and with Entities Relevant to Engagements

Section 4 – Fees, Remuneration and Evaluation Policies, Gifts and Hospitality, Litigation

Section 5 – Non-audit / Additional Services

PREFACE

The FRC's Ethical Standard applies in the audit of financial statements and other *public interest assurance engagements*. It is read in the context of the Statement "The Financial Reporting Council – Scope and Authority of Audit and Assurance Pronouncements" which sets out the application and authority of the FRC's Ethical Standard.

The terms used in the FRC's Ethical Standard are explained in the Glossary on the FRC's website.

The FRC's Ethical Standard applies to audits of financial statements and other *public interest assurance engagements* in both the private and the public sectors.

Introduction

Scope of this Ethical Standard

I1 This Ethical Standard applies to *audit engagements* and other *public interest assurance engagements*[1]. The term '*engagement*' is used in this Ethical Standard specifically to mean an *audit engagement* or *other public interest assurance engagement*, or both where the context permits, unless stated otherwise. A fundamental objective of any such *engagement* is that the intended users trust and have confidence that the audit or assurance opinion is professionally sound and objective. This in turn should enhance the credibility for users of the information the opinion covers (the '*subject matter information*'[2] – e.g. in the case of an *audit engagement*, the financial statements). It should also enhance the intended users' understanding of the underlying '*subject matter*' (e.g. in the case of an *audit engagement*, the historical financial position and performance of the entity).

I2 Users are neither responsible for the *subject matter information* nor for the underlying *subject matter* of the *engagement*. Their interest in the *engagement* usually arises because they have an actual or prospective stake in an *entity relevant to the engagement* but do not have direct access to the *subject matter*.

I3 Although auditors and assurance practitioners are reporting to users, they are generally engaged to do so by the entity whose information they are reporting on. Accordingly their contractual 'client' (the entity) is different to their beneficial 'client' (the users). These principal-agent relationships (where the users are the principals and the directors and auditors of the entity their agents) give rise to the potential for conflicts of interests that need to be addressed if the user is to have trust and confidence in the audit/assurance process, the *subject matter information* and the directors of the entity itself. Regulation and oversight of audit and assurance practitioners, including professional and ethical codes and standards, addresses the need for trust and confidence between users and practitioners. The *engagement* then addresses the need for trust and confidence between the users and the directors of the entity.

---

[1] Audits of financial statements(*) undertaken in compliance with International Standards on Auditing (ISAs) (UK) and other engagements undertaken in compliance with performance standards issued by the FRC which, as of 17 June 2016, comprise:

a. *Reporting accountants* acting in connection with an *investment circular* (the Standards for Investment Reporting – 'SIRs');

b. Review of interim financial information by the independent auditor of the entity (International Standard on Review Engagements (UK and Ireland) 2410); and

c. Engagements to provide assurance on client assets to the Financial Conduct Authority (the CASS Standard).

(*) In the public sector the statutory scope of an audit can extend beyond the entity's financial statements to include reporting on an entity's arrangements for the proper conduct of its financial affairs, management of its performance or use of its resources.

[2] '*Subject matter information*' is the outcome that results from the evaluation or measurement of '*subject matter*' against suitable criteria. More full definitions are given in the Glossary of Terms.

I4 In the context of an *engagement*, such conflicts of interest create a potential risk (threat) that the practitioner's judgment or actions in conducting or determining the outcome of the *engagement* may be unduly influenced by interests other than those of the intended user (the beneficial 'client' under the *engagement*). Such other interests are potentially wide-ranging and will usually be legitimate in themselves (though they may also not be so). However, they would be objectionable in the circumstances if the practitioner is unduly influenced by them, because this may prejudice the interests of the intended users, which should be paramount.

I5 Users do not have all the information necessary for judging whether the *firm*, its partners and *staff* and any other *covered persons* are, in fact, acting with integrity and objectivity. Although the *firm* may be satisfied that the integrity, objectivity and independence of the *firm* or such persons will not in fact be compromised by a particular condition or relationship, an objective, reasonable and informed third party may reach a different conclusion. For example, if such a third party were aware that the *firm*, its partners or *staff* and/or any other *covered persons* had certain financial, employment, business or personal relationships with an *entity relevant to the engagement*, that third party might reasonably conclude that the *firm* and such persons could be subject to undue influence from the directors of the entity or would not be impartial or unbiased. Public confidence in the integrity, objectivity and independence of the *firm* or such persons could therefore suffer as a result of this perception, irrespective of whether there is any actual impairment.

I6 Other regulators or competent authorities may specify compliance with this Ethical Standard in relation to other types of work.

I7 Ethical guidance on other matters, together with statements of fundamental ethical principles governing the work of all professional accountants, are issued by professional accountancy bodies. These also provide a basis for enhancing the trust and confidence of intended users that the *engagement* is professionally sound.

Investment Circular Reporting Engagements

I8 Because investment circulars may relate to transactions that are price sensitive and therefore confidential, the fact that a *firm* has been engaged to undertake an *investment circular reporting engagement* is likely to be known by only a limited number of individuals within the *firm*. For this reason, for such engagements, the supporting ethical provisions and requirements of this Ethical Standard apply only to.

(a) persons with actual knowledge of the engagement as described in the definition of *covered persons* applicable to an *investment circular reporting engagement*; and

(b) where required by this Ethical Standard, the *firm*.

Meeting the Ethical Outcomes Established by the Overarching Principles, Supporting Ethical Provisions and Specific Requirements

I9 Part A of this Ethical Standard sets out the overarching principles of integrity, objectivity and independence, together with supporting ethical provisions. Together, these establish a framework, of ethical outcomes that are required

to be met by the auditor or assurance practitioner, to provide a basis for user trust and confidence in the integrity and objectivity of the practitioner in performing the *engagement*.

I10 Part B sets out specific requirements relevant to certain circumstances that may arise in audit and other *public interest assurance engagements*. These specific requirements are designed to assist in meeting the ethical outcomes required by the overarching principles and supporting ethical provisions. However, circumstances relating to *engagements* vary widely and meeting the ethical outcomes required by the overarching principles and supporting ethical provisions is paramount. Compliance with the specific requirements may not always be sufficient to achieve this as Part B does not, nor is it practicable for it to, address all possible circumstances that may exist. Accordingly practitioners need to be alert for, and respond appropriately to, other circumstances that create threats to meeting the ethical outcomes required by the overarching principles and supporting ethical provisions.

I11 The *firm* and persons required to meet the outcomes of the overarching principles and supporting ethical provisions are required to be able to demonstrate that they have, where applicable, identified and addressed relevant conditions and circumstances, including that they have:

- implemented, maintained and/or complied with effective systems and processes to enable them to do so;
- established and operated effective safeguards;
- evaluated the threats and safeguards appropriately; and
- taken any additional steps that are necessary to meet the ethical outcomes required by the overarching principles and supporting ethical provisions.

I12 The FRC believes that stakeholders (users of practitioner's reports issued under *engagements*) expect an equivalent standard of independence for *firm*s, their partners and other *covered persons*, whether performing audit or other *public interest assurance engagements*. *Firm*s, their partners and *staff*, and other persons where identified, are required to meet the ethical outcomes required by the overarching principles and supporting ethical provisions and to comply with the requirements unless the circumstances to which they apply do not exist.

I13 When a statement or examples are given in this Ethical Standard to help clarify or illustrate a position in relation to particular circumstances, this is not intended to, and should not be interpreted as, indicating that in other circumstances the same position necessarily either is or is not intended. Whether the ethical outcomes required by the overarching principles and supporting ethical provisions are achieved is always paramount and is a matter to be determined exercising professional judgment.

The 'Third Party Test'

I14 Importantly, consideration of whether the ethical outcomes required by the overarching principles and supporting ethical provisions have been met should be evaluated by reference to the perspective of an objective, reasonable and informed third party (see the definition of *independence*).

I15 The *firm*, as well as each *covered person*, is required to be independent in the performance (conduct and determination of the outcome) of the *engagement*. Complete freedom from threats to integrity and objectivity, even taking into account safeguards, is not feasible, for example, as a result of the influence that the directors and management of a responsible entity have over the appointment and remuneration of the *firm* where (as in the case of an audit) that entity is the engaging party. Accordingly, independence not being compromised (which is the test to be applied in evaluating the likely consequences of conditions and relationships that may create threats to integrity and objectivity) is not whether the *firm* considers that the integrity and objectivity of the *firm*, its partners and *staff* and any other *covered persons* is impaired, but is whether there is freedom from threats to integrity and objectivity, taking into account safeguards applied, at a level where it is probable (more likely than not) that an objective, reasonable and informed third party would not conclude that integrity or objectivity (and therefore independence) is compromised. This is identified more concisely in Parts A and B of this Ethical Standard as a 'level at which independence is not compromised'.

Threats to Integrity, Objectivity and Independence

I16 When the threats that exist mean that independence is, or is perceived to be, compromised, an objective, reasonable and informed third party would not have sufficient trust and confidence in the practitioner to perform or continue to perform the *engagement*. Consequently, in those circumstances actions have to be taken: to remove or reduce the threats; or to apply additional safeguards; or, where the threats relate to individuals rather than the *firm*, to exclude those individuals from any role which would put them in a position as a *covered person* to exert influence on the *engagement*. These actions must be taken individually or collectively to such an extent that it is probable that an objective, reasonable and informed third party would no longer conclude that integrity or objectivity (and therefore independence) are compromised. Otherwise, the *firm* is not permitted to accept, or if already engaged is required to withdraw from, the *engagement* unless not permitted to do so by legislation.

I17 Conditions and relationships that affect the *firm* or its *network firm*s and their partners and *staff* and any other *covered persons* are relevant in the context of identifying conflicts of interest that may give rise to threats to integrity or objectivity in the performance of the *engagement*. Individuals who perform an *engagement* do so in the context of the *firm*'s cultural and ethical values, and its governance and management arrangements (including its quality control systems). In turn, the *firm* operates in the context of its wider network, if any. Accordingly, such conditions and relationships that are relevant in the context of an *engagement* may arise within the *firm* or its network or externally.

I18 Relevant internal conditions would include, for example, the culture, governance and management arrangements within the *firm* and its *network firms*, and their policies and practices with respect to performance, pay and promotion. These internal conditions are expressed, in the context of those responsible for the performance of the *engagement*, through the formal and informal relationships of influence they have with other persons within the *firm*, and potentially within the *firm*'s network, and in turn any such relationships that those other persons may have internally. Such other persons within the *firm* may therefore be *covered persons* in a position to influence the conduct or outcome of the engagement.

I19 Relevant external relationships would include, for example: family and personal relationships of *covered persons*; financial, business and employment relationships of the *firm* or such individuals (or closely connected persons) with an *entity relevant to the engagement* and potentially with other entities; and relationships with an *entity relevant to the engagement* that arise in the performance of the *engagement* or other services provided to those entities. Relevant external conditions may include, for example: the culture, governance and management of the entity; long association of those performing the *engagement* with an *entity relevant to the engagement*; and economic dependence on an *entity relevant to the engagement*.

The EU Audit Directive and Regulation

I20 In April 2014 the European Commission published a Directive[3] amending the Statutory Audit Directive[4] and a new Audit Regulation[5]. The Audit Directive establishes specific requirements concerning the *statutory audit* of annual and consolidated financial statements. The Audit Regulation establishes further specific requirements regarding the *statutory audit* of '*public interest entities*' as defined by the Audit Directive (see the definitions below).

I21 The Audit Regulation has the direct effect of law and Member States are required to adopt appropriate provisions to ensure its effective application. The Audit Directive does not have a direct effect in law and Member States are required to adopt and publish the measures necessary to comply with it. Articles in both the Audit Directive and Audit Regulation establish provisions that relate to matters that are the subject of this Ethical Standard. In relation to a number of these provisions there are Member State options that have been implemented in this Ethical Standard.

I22 The overarching principles, supporting ethical provisions and requirements in this Ethical Standard reflect the Audit Directive and Regulation where relevant. These requirements are highlighted with shading and 'D' (for the Directive) or 'R' (for the Regulation) added to the paragraph number as applicable.

Definitions

I23 Particular terms used in the FRC's Ethical Standard are explained in the Glossary which is available on the FRC website. Defined terms are presented in italicised text.

Integrity, Objectivity and Independence

Integrity – being trustworthy, straightforward, honest, fair and candid; complying with the spirit as well as the letter of applicable ethical principles, laws and regulations; behaving so as to maintain the public's trust in the auditing profession; and respecting confidentiality except where disclosure is

[3] Directive 2014/56/EU

[4] Directive 2006/43/EC

[5] Regulation 537/2014

in the public interest or is required to adhere to legal and professional responsibilities.

Objectivity – acting and making decisions and judgments impartially, fairly and on merit (having regard to all considerations relevant to the task in hand but no other), without discrimination, bias, or compromise because of commercial or personal self-interest, conflicts of interest or the undue influence of others, and having given due consideration to the best available evidence.

The need for objectivity in performing the engagement arises from, among other things, the fact that many of the important issues involved in the performance of the engagement, including those arising in the preparation of the subject matter information, do not relate to questions of fact but rather to questions of judgment. For example, with regard to financial statements, there are choices to be made by the board of directors in deciding on the accounting policies to be adopted by the entity: the directors have to select the ones that they consider most appropriate and this decision can have a material impact on the financial statements. Furthermore, many items included in the financial statements cannot be measured with absolute precision and certainty. In many cases, estimates have to be made and the directors may have to choose one value from a range of possible outcomes. When exercising discretion in these areas, the directors have regard to the applicable financial reporting framework.

Independence – freedom from conditions and relationships which, in the context of an *engagement*, would compromise the integrity or objectivity of the *firm* or *covered persons*.

Integrity or objectivity (and therefore independence) would be compromised if it is probable (more likely than not) that an objective, reasonable and informed third party would conclude that the threats, arising from any conditions or relationships that exist (taking into account any conflicts of interest that they may cause, or generally be perceived to cause, or otherwise, and having regard to any safeguards implemented), would impair integrity or objectivity to such an extent that it would be inappropriate for the firm to accept or continue to perform the audit or other public interest assurance engagement unless the threats were eliminated or further reduced or unless more, or more effective, safeguards were implemented.

Part A – Overarching Principles and Supporting Ethical Provisions

The overarching principles of integrity, objectivity and independence established by this Ethical Standard are set out below together with the related supporting ethical provisions. Cross references are given to the Sections in Part B of this Ethical Standard that establish related requirements and/or guidance.

Integrity and Objectivity

Overarching Principle

1. The *firm*, its partners[6] and all *staff*[7] shall behave with integrity and objectivity in all professional and business activities and relationships.

Supporting Ethical Provisions

1.1 The senior management of the *firm* and those with direct responsibility for the management of the *firm*'s audit and other public interest assurance business shall instil the necessary culture and behaviours respectively throughout the *firm* and that business, so as to ensure that meeting the ethical outcomes of the overarching principles and supporting ethical provisions is paramount and overrides all commercial interests of the *firm*.	1.1 – 1.25 Compliance
1.2 The *firm* shall establish and apply confidential whistle-blowing policies and procedures across the *firm* which enable partners and *staff* to report, without fear, concerns about the *firm*'s commitment to quality work and professional judgment and values in a way that properly takes the public interest into consideration.	1.11(h)

Independence

Overarching Principle

2. In relation to each *engagement*, the *firm*, and each *covered person*, shall ensure (in the case of a *covered person*, insofar as they are able to do so) that the *firm* and each *covered person* is free from conditions and relationships which would make it probable that an objective, reasonable and informed third party would conclude the independence of the *firm* or any *covered person* is compromised.

---

[6] The term 'partner' includes any individual with authority to bind the *firm* with respect to the performance of a professional services engagement.

[7] The term 'staff' includes any natural persons whose services are placed at the disposal or under the control of the *firm.*

Supporting Ethical Provisions

2.1D The *firm* and each *covered person*, shall ensure (in the case of a *covered person*, insofar as they are able to do so) that the independence of the *firm* and each *covered person* is not compromised with respect to each *entity relevant to the engagement*. This includes ensuring that the *firm* and each *covered person* is not involved in the decision-taking of any such entity. The period during which independence shall not be compromised is:

(a) In the case of an audit, at least throughout the period covered by the financial statements to be audited and throughout any subsequent period until the audit has been completed;

(b) In the case of an other *public interest assurance engagement*, other than an *investment circular reporting engagement*, at least throughout any period over which, or from the time as at which, the *subject matter* is measured or evaluated in connection with the engagement and throughout any subsequent period until the *engagement* has been completed;

(c) In the case of an investment circular reporting engagement, the period during which the engagement is undertaken and any additional period before that but subsequent to the balance sheet date of the most recent audited financial statements of the *entity relevant to the engagement*. [AD 22.1]

2.2D The *firm* shall take all reasonable steps to ensure that, when carrying out an *engagement*, the integrity, objectivity and independence of the *firm* and each *covered person* is not affected by any existing or potential conflict of interest or any business or other direct or indirect relationship involving:

(i) the *firm*; or where applicable any members of its network;

(ii) any of the *firm*'s partners or *staff*; or

(iii) the *firm*'s owners, shareholders or any other person directly or indirectly linked to the *firm* by control. [AD 22.1]

1.26 – 1.44

Identification and Assessment of Threats

1.45 – 1.52

Identification and Assessment of Safeguards

1.53 – 1.55

Other Firms

2.3D The *firm* shall not accept, continue or carry out an *engagement*:

(i) if there is any threat of self-review, self-interest, advocacy, familiarity or intimidation created by

1.26 – 1.44

Identification and Assessment of Threats

1.45 – 1.52

Identification and Assessment of Safeguards

financial, personal, business, employment or other relationships between:

(a) the *firm*, any of its *network firms*, or any *covered person*, and

(b) any *entity relevant to the engagement*; or

(ii) unless required by law or regulation to do so, if any other condition or relationship exists;

which would compromise the independence of the *firm* or any *covered person*. [AD 22.1]

1.53 – 1.55

Other *Firm*s

1.57 – 1.60

Overall Conclusion

Section 2 – Financial, Business, Employment and Personal Relationships

Section 3 – Long Association with Engagements and with Entities Relevant to Engagements

2.4 For each *engagement*, the *firm* and the *engagement partner* (in the case of the *engagement partner* insofar as they are able to do so) shall ensure that the *firm*'s independence is not compromised as a result of conditions or relationships that would compromise the independence of a *network firm* (whether or not its work is used in the conduct of engagement) or a third party *firm* whose work is used in the conduct of the engagement, having regard to the ethical requirements that are relevant to the engagement as applicable to such other *firm*, which are as follows:

(a) For each such other *firm*, the extant version of the IESBA Code[8]; and

(b) In the case of a *network firm* whose work is used in the conduct of an *engagemen*t where any *entity relevant to the engagement* is a *public interest entity*, this Ethical Standard.

1.53 – 1.55

Other Firms

1.61 – 1.71

Communication with Those Charged with Governance

2.5 In evaluating whether or not a condition or relationship would compromise independence, it is the responsibility of (i) the *firm*, and (ii) each *covered person* and any other person with responsibility to behave with integrity and objectivity and to maintain their independence (or to ensure that others do so); to be able to demonstrate that any conditions or relationships that exist, taking account of any safeguards implemented, would not compromise the independence of the *firm* or any *covered person*.

1.5 – 1.7

Compliance

2.6 All partners and *staff* of the *firm* and all other *covered persons* shall remain alert to conditions or relationships

1.26 – 1.44

[8] The 'Code of Ethics for Professional Accountants' issued by the International Ethics Standards Board for Accountants

which could compromise the independence of the *firm* or any *covered person*.	Identification and Assessment of Threats
2.7 All partners and *staff* of the *firm* and all other *covered persons* who become aware of any condition or relationship which could impair the independence of the *firm* or any *covered person* shall report the matter to the *engagement partner* (if known) or (failing that) to the *firm*'s *Ethics Partner*/Function, where applicable, or otherwise to the senior management of the *firm* or those with direct responsibility for the management of the *firm*'s audit and other public interest assurance business, at the earliest opportunity.	
2.8 The *firm* shall have policies and procedures designed to ensure that action is taken promptly: to investigate any condition or relationship reported in accordance with supporting ethical provision 2.7, to assess whether the independence of the *firm* or any *covered person* would be compromised and, if so, to eliminate the condition or relationship or apply sufficient safeguards, to reduce threats to a level where the independence of the *firm* and *covered persons* is not compromised, or to withdraw from the *engagement*.	1.45 – 1.52 Identification and Assessment of Safeguards 1.57 – 1.60 Overall Conclusion
2.9 In relation to an *engagement*, a *firm* shall not:	
• agree a basis for determining fees, or	Section 4 (4.1 – 4.55)
• have remuneration and evaluation policies for partners and *staff*,	Section 4 (4.56D – 4.60)
which would compromise the independence of the *firm* or of any *covered person*.	
2.10 The *firm*, its partners and *staff* and any other *covered person*, and *persons closely associated* with *covered persons*, shall not provide or accept gifts and hospitality in relation to an *engagement* unless it is probable that an objective, reasonable and informed third party would consider the value thereof to be trivial or inconsequential.	Section 4 (4.61D – 4.65)
2.11 The *firm* shall not accept or continue an *engagement* for an entity, unless required by law to do so, where litigation in relation to any *engagement* between the *firm* its partners or any *covered person* and the entity or its *affiliates* is already in progress, or where the *engagement partner* considers such litigation to be probable, and which would compromise the independence of the *firm* or any *covered person*.	Section 4 (4.66 – 4.68)
2.12 The *firm* shall not provide any *non-audit* / *additional services* to an *entity relevant to an engagement*, where such	Section 5

provision would compromise the independence of the *firm* or any *covered person*.

2.13 Failure to comply with a requirement of this Ethical Standard shall be deemed to compromise independence unless such failure has been addressed in accordance with paragraphs 1.22 and 1.23 of Section 1 of Part B of this Ethical Standard.

Part B

Section 1 – General Requirements and Guidance

Compliance

1.1D **The *firm* shall establish appropriate policies and procedures to ensure that its owners or shareholders, as well as the members of the administrative, management and supervisory bodies of the *firm*, or of an *affiliate firm*, do not intervene in the carrying-out of an *engagement* in any way which jeopardises the integrity, objectivity or independence of the *firm* or *covered persons*;** [AD 24a.1(a)]

1.2D **The *firm* shall establish appropriate and effective organisational and administrative arrangements:**

(a) that are designed to prevent, identify, eliminate or manage and disclose any threats to its independence; [AD 24a.1(e)]

(b) for dealing with and recording incidents which have, or may have, serious consequences for the integrity of its audit or other public interest assurance activities; [AD24a.1(i)]

1.3D **The *firm* shall take into consideration the scale and complexity of its activities when complying with the requirements set out in paragraphs 1.1D and 1.2D.** [AD 24a.2]

1.4D **The *firm* shall be able to demonstrate to the FRC (or the Recognised Supervisory Body to whom the FRC has delegated regulatory tasks, where applicable) that the policies and procedures designed to achieve such compliance with the requirements in paragraphs 1.1D and 1.2D are appropriate given the scale and complexity of activities of the *firm*.** [AD 24a.2]

1.5 **The *firm*, its partners and *staff* shall, in so far as they are required to meet the ethical outcomes of the overarching principles and supporting ethical provisions in this Ethical Standard, be able to demonstrate that they have done so. This shall include, in so far as applicable to their roles, being able to demonstrate that they have:**

- **implemented and maintained, and/or complied with, effective systems and processes to enable meeting those outcomes;**
- **identified and reported relevant conditions and circumstances that threaten meeting those outcomes;**
- **established and operated effective safeguards;**
- **evaluated the threats and safeguards appropriately;**
- **taken any additional steps that are appropriate in the circumstances to meet those outcomes.**

1.6 The specific requirements in Sections 1 – 5 of Part B of this Ethical Standard are designed to assist in meeting the ethical outcomes of the overarching principles and supporting ethical provisions. However, circumstances relating

to *engagements* vary widely and meeting these ethical outcomes is paramount. Compliance with the specific requirements may not be sufficient to do so as they do not address all possible circumstances.

1.7 When a statement or examples are given in this Ethical Standard to help clarify or illustrate a position in relation to particular circumstances, this is not intended to, and should not be interpreted as, indicating that in other circumstances the same position necessarily either is or is not intended. Whether the ethical outcomes of the overarching principles and supporting ethical provisions are met is always paramount and is a matter to be determined exercising professional judgment.

1.8 Meeting the ethical outcomes of the overarching principles and supporting ethical provisions, and complying with the specific requirements, regarding integrity, objectivity and independence is a responsibility of both the *firm* and of individual partners and *staff*. The *firm* establishes policies and procedures, appropriate to the size and nature of the *firm*, to promote and monitor meeting the ethical outcomes of the overarching principles and supporting ethical provisions, and compliance with the specific requirements, by the *firm*, its partners and its *staff*.[9,]

1.9 Supporting ethical provision 1.1 establishes that the senior management of the *firm*, and those with direct responsibility for the management of the *firm*'s audit and other public interest assurance business, instil the necessary culture and behaviours throughout the *firm* so as to ensure that meeting the ethical outcomes of the overarching principles and supporting ethical provisions is paramount and supersedes all commercial interests of the *firm*. The senior management of the *firm* influences the internal culture of the *firm* by its actions and by its example ('the tone at the top'). Achieving a robust control environment requires that the senior management give clear, consistent and frequent messages, backed up by appropriate actions, which emphasise the importance of meeting the ethical outcomes of the overarching principles and supporting ethical provisions for *audit* and other *public interest assurance engagements* by all parts of the *firm*, including those parts that are not involved in providing audit and other public interest assurance services.

1.10 **The senior management of the *firm*, and those with direct responsibility for the management of the *firm*'s audit and other public interest assurance business, shall establish appropriate policies, procedures and quality control and monitoring systems; dedicate appropriate resources and leadership to compliance with supporting ethical provision 1.1; and make appropriate arrangements with *network firms* to ensure compliance as necessary across the network. The *firm* shall ensure that such appropriate policies, procedures and quality control and monitoring systems are implemented and operated effectively.**

1.11 In order to promote a strong control environment, the *firm* establishes policies and procedures that include:

---

[9] Monitoring of compliance with ethical requirements will often be performed as part of a broader quality control process. ISQC (UK) 1 (Revised June 2016) *'Quality Control for Firms that Perform Audits and Reviews of Financial Statements and other Assurance and Related Services Engagements*' establishes requirements in relation to a *firm's* responsibilities for its system of quality control for audits.

(a) requirements for its partners and *staff* to report where applicable in relation to an *entity relevant to an engagement* by the *firm*:

- family and other personal relationships involving such an entity;
- financial interests in such an entity;
- decisions to join such an entity.

(b) monitoring of compliance with the *firm*'s policies and procedures relating to integrity, objectivity and independence. Such monitoring procedures include, on a test basis, periodic review of the *engagement partners'* documentation of the consideration of the integrity, objectivity and independence of the *firm*, its partners and *staff*, addressing, for example:

- financial interests in *entities relevant to an engagement* by the *firm*;
- economic dependence on *entities relevant to an engagement* by the *firm*;
- the performance of *non-audit / additional services*;
- *engagement partner* rotation;

(c) identification of the entities which partners and *staff*, and, where applicable, *persons closely associated* with them, need to be independent from;

(d) arrangements for prompt communication of possible or actual breaches of the *firm*'s policies and procedures to the relevant *engagement partners*;

(e) evaluation by *engagement partners* of the implications of any identified possible or actual breaches of the *firm*'s policies and procedures that are reported to them;

(f) reporting by *engagement partners* of particular circumstances or relationships as required by this Ethical Standard;

(g) operation of an enforcement mechanism to promote compliance with policies and procedures;

(h) empowerment of its *staff* to communicate without fear to senior levels within the *firm* any concerns about the *firm*'s commitment to quality work and professional judgment and values, including issues of integrity, objectivity or independence that concerns them; this includes establishing confidential communication channels open to *staff*, encouraging *staff* to use these channels and ensuring that *staff* who use these channels are not discriminated against and are not subject to disciplinary proceedings as a result.

Ethics Partner

1.12 **The senior management of the *firm* shall designate a partner in the *firm* possessing the necessary seniority, relevant experience, authority and leadership levels (the '*Ethics Partner*') as having responsibility for ensuring the *firm*'s compliance with supporting ethical provision 1.1. The *Ethics Partner* is supported, where appropriate, by other persons with relevant experience in the *firm*, comprising an 'Ethics Function'. The *Ethics Partner* shall have direct reporting lines to the *firm*'s**

leadership Board and to the *firm*'s independent non-executives, where applicable.

1.13 **Save where the circumstances contemplated in paragraph 1.20 apply, the responsibilities of the *Ethics Partner* shall include:**

(a) the adequacy of the *firm*'s policies and procedures relating to integrity, objectivity and independence, meeting the ethical outcomes required by the overarching principles and supporting ethical provisions, and compliance with the requirements of this Ethical Standard, and the effectiveness of its communication to its partners and *staff* on these matters within the *firm*; and

(b) providing related guidance to individual partners and *staff* with a view to achieving a consistent approach to the application of this Ethical Standard.

1.14 **If differences of opinion arise between the *Ethics Partner* and persons consulting him or her, the *firm*'s policies and procedures for dealing with and resolving differences of opinion shall be followed[10].**

1.15 The *Ethics Partner* is an individual with seniority and authority at leadership levels within the *firm*, possessing relevant experience, and whose decisions and advice on ethical matters will be respected by persons at all levels within the *firm*, including by any more senior partners. Experience of audit and/or other *public interest assurance engagements* would be useful.

1.16 **The *Ethics Partner* shall not undertake another role within the *firm* which conflicts with their responsibilities as Ethics Partner.**

1.17 Where the *Ethics Partner* undertakes this role together with a role such as Compliance or Risk Management he or she ensures that the responsibilities of the *Ethics Partner* take precedence over the responsibilities of other functions. Where the *Ethics Partner* is supported by an Ethics Function, the *Ethics Partner* retains overall responsibility for operation of that function and the decisions made and advice given by it.

1.18 In the case of *firm*s that undertake *engagements* for *public interest entities* (PIEs) or other *listed entities*, the *Ethics Partner* has direct access to the *firm*'s independent non-executives where such roles are introduced in the *firm*[11] or, alternatively, to the *firm*'s most senior governance body.

1.19 In assessing the effectiveness of the *firm*'s communication of its policies and procedures relating to integrity, objectivity and independence, the *Ethics Partner* considers whether ethics are covered properly in the *firm*'s induction programmes, professional training and continuing professional development for all partners and *staff*. *Ethics Partners* also provide guidance on matters referred to them and on matters, which they otherwise become aware of, where a difficult and objective judgment needs to be made or a consistent

[10] ISQC (UK) 1 (Revised June 2016), paragraph 43, requires firms to establish policies and procedures for dealing with and resolving differences of opinion with those consulted.

[11] *Firms* that comply with the Audit Firm Governance Code will have appointed independent non-executives who should have the majority on a body that oversees public interest matters. Other firms may also have independent non-executives.

position reached. The *Ethics Partner* is proactive in considering the ethical implications of developments in the business of the *firm* and the environment in which it operates and in providing advice and guidance to partners and *staff* where appropriate.

1.20 In *firm*s with three or fewer partners who are 'Responsible Individuals'[12], it may not be practicable for an *Ethics Partner* to be designated. In these circumstances all partners will regularly discuss ethical issues amongst themselves, so ensuring that they act in a consistent manner and observe the overarching principles and supporting ethical provisions set out in this Ethical Standard. In the case of a sole practitioner, advice on matters where a difficult and objective judgment needs to be made is obtained through the ethics helpline of the practitioner's professional body, or through discussion with a practitioner from another *firm*. In all cases, it is important that such discussions are documented.

1.21 **To be able to discharge his or her responsibilities, the *Ethics Partner* shall be provided with sufficient staff support and other resources (the Ethics Function), commensurate with the size of the *firm*. Alternative arrangements shall be established to allow for:**

- **the provision of guidance on those audits or other *public interest assurance engagements* where the *Ethics Partner* is the *engagement partner*; and**
- **situations where the *Ethics Partner* is unavailable, for example due to illness or holidays.**

Where such support is shared with other functions such as Compliance or Risk Management, the *Ethics Partner* shall establish policies and procedures to ensure that:

- **matters delegated to the Ethics Function by the *Ethics Partner*, whether directly or indirectly through the operation of delegation policies established by the *Ethics Partner*, are clearly identified in internal documentation as relating to the *Ethics Partner* role and are addressed and supervised in a manner consistent with the *Ethics Partner* role, avoiding conflicts with other objectives; and**
- **all matters required to be communicated to, consulted upon with, or approved by the *Ethics Partner* are communicated to him or her or an authorised delegate personally, on a timely basis.**

Breaches

1.22 Whenever a possible or actual breach of this Ethical Standard, or of policies and procedures established pursuant to the overarching principles and supporting ethical provisions and requirements established in it, is identified, the *engagement partner*, in the first instance, and the *Ethics Partner*, where appropriate, assesses the implications of the breach, determines whether there are safeguards that can be put in place or other actions that can be taken to address any potential adverse consequences and considers whether there is a need to resign or withdraw from the *engagement*.

[12] A 'Responsible Individual' is a partner or employee of the *firm* who is responsible for audit work and designated as such under the audit regulations of a Recognised Supervisory Body.

1.23 An inadvertent violation of this Ethical Standard does not necessarily call into question the *firm*'s ability to give an audit or other public interest assurance opinion, provided that:

(a) the *firm* has established policies and procedures that require all partners, *staff* and other *covered persons* to report any breach promptly to the *engagement partner* or to the *Ethics Partner*, as appropriate;

(b) the *engagement partner* or *Ethics Partner* promptly notifies the relevant partner, member of *staff* or other *covered person* that any matter which has given rise to a breach is to be addressed as soon as possible and ensures that such action is taken;

(c) safeguards, where appropriate, are applied, (for example, having another partner review the work done by the relevant partner, member of *staff* or other *covered person* or removing him or her from the *engagement team* or from otherwise being a *covered person*; and

(d) the actions taken and the rationale for them are documented.

Non-involvement in Management Decision-taking

1.24 Supporting ethical provision 2.1D requires that the *firm* and each *covered person* is not involved in the decision-taking of an *entity relevant to the engagement*. Paragraph 5.167R of Section 5 of Part B of this Ethical Standard requires in accordance with the EU Audit Regulation that, in the case of a *statutory audit* of a *public interest entity*, *non-audit services* shall not be provided that involve playing any part in the management or decision-making of an *audited entity*.

1.25 It is not possible to specify all types of decision that are the responsibility of management, but they typically involve leading and directing the entity, including making significant judgments and taking decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources. Examples of judgments and decisions that should not be made by the *firm* or a *covered person* include:

- Setting policies and strategic direction;
- Directing and taking responsibility for the actions of the entity's employees;
- Authorising transactions;
- Deciding which recommendations of the *firm* or other third parties should be implemented;
- Taking responsibility for the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework;
- Taking responsibility for the preparation and presentation of *subject matter information* in the case of an other *public interest assurance engagement*; and
- Taking responsibility for designing, implementing and maintaining internal control.

Identification and Assessment of Threats

1.26 The *engagement partner* identifies and assesses the circumstances which could adversely affect the integrity or objectivity of the *firm* or of *covered persons* ('threats'), including any that could impair independence, and applies procedures ('safeguards'), which will either:

(a) eliminate the threat (for example, by eliminating the circumstances, such as removing an individual from the *engagement team* or disposing of a financial interest in the entity); or

(b) reduce the threat to level at which independence is not compromised.

1.27D **If, during the period covered by the financial statements or by an other *public interest assurance engagement*, an *entity relevant to the engagement* is acquired by, merges with, or acquires another entity, the *firm* and each relevant engagement partner shall identify and evaluate any current or recent interests or relationships, including any *non-audit / additional services* provided to that entity, which, taking into account available safeguards, could compromise the integrity, objectivity or independence of the *firm* or *covered persons* and the ability to continue with the *engagement* after the effective date of the merger or acquisition. As soon as possible, and in any event within three months, the *firm* and each relevant *engagement partner* shall take all such steps as may be necessary to terminate any current interests or relationships that would compromise integrity, objectivity or independence and shall, where possible, adopt safeguards to eliminate or reduce any threat to integrity or objectivity, including any threats that could impair independence, arising from prior and current interests and relationships, to a level where independence is not compromised.** [AD 22.6]

Threats to Integrity, Objectivity and Independence

1.28 When complying with supporting ethical provisions 2.1D – 2.3D, conditions and relationship that could give rise to threats to the integrity, objectivity or independence of the *firm* or *covered persons* are communicated to the appropriate person, having regard to the nature of the threats and to the part of the *firm* and the identity of any person involved. The consideration of all threats on an individual and cumulative[13] basis and the action taken is documented. If the *engagement partner* is personally involved in the threat, or is unsure about the action to be taken, the matter is resolved through consultation with the *Ethics Partner* / Function who should be provided with all facts relevant to consideration of the issue.

1.29 The principal types of threats to the integrity, objectivity and independence of the *firm* and *covered persons* are:

- ***self-interest threat***

  A self-interest threat arises when any of the *firm*, its partners, *staff* or other *covered persons*, has financial or other interests which might cause the *firm* or any *covered person* to be, or perceived to be, reluctant

[13] For this purpose, 'cumulative' means all current relationships and any past completed relationships that may be expected to have a continuing relevance to the auditor's independence and consideration of the threats that might exist.

to take actions in connection with the engagement that would be adverse to such interests of the *firm* or any *such person.* For example, such interests may include holding an investment in the entity, seeking to provide additional services to the entity or needing to recover long-outstanding fees from the entity. In relation to *non-audit / additional services*, the main self-interest threats concern fees and economic dependence and these are addressed in Section 4 of this Ethical Standard.

- ***self-review threat***

  A self-review threat arises when the results of *non-audit / additional services*, or where the *subject matter* of such services, whether performed by the *firm*, the *engagement team* or others within the *firm*, are addressed in the *engagement* or reflected in the amounts included or disclosed in the financial statements or other *subject matter information* of the *engagement.* For example, a self-review threat may arise where the *firm* has been involved in maintaining the accounting records, or undertaking valuations that are incorporated in financial statements that the *firm* audits or reports on in relation to an initial public offering. In the course of the *engagement*, the persons conducting the *engagement* may need to re-evaluate the work performed in the *non-audit / additional service*. As, by virtue of providing the *non-audit / additional service*, the *firm* is associated with aspects of the preparation of the financial statements or other *subject matter* or *subject matter information* relating to the *non-audit / additional services*, the *firm* or *covered person* may be, or may be perceived to be, unable to take an impartial view of relevant aspects of those financial statements or other *subject matter information*.

  In assessing the significance of the self-review threat, the persons conducting the *engagement* consider the extent to which the *non-audit / additional service* will:

  - involve a significant degree of subjective judgment; and
  - have a material effect on the preparation and presentation of the financial statements or other *subject matter information* or *subject matter* of the *engagement*.

  Where a significant degree of judgment is involved in a *non-audit / additional service* relating to the financial statements, or other *subject matter information*, or to the *subject matter* of an *engagement*, the persons conducting the *engagement* may be inhibited from questioning that judgment in the course of the *engagement*. Whether a significant degree of subjective judgment is involved will depend upon whether the *non-audit / additional service* involves the application of well-established principles and procedures, and whether reliable information is available. If such circumstances do not exist because the *non-audit / additional service* is based on concepts, methodologies or assumptions that require judgment and are not established by the entity or by authoritative guidance, the integrity and objectivity of the *firm* and *covered persons* and their independence could be compromised. Where the provision of a proposed *non-audit / additional service* would also have a material effect on the financial statements, or other *subject matter information*, or on the *subject matte*r of an *engagement*, it is unlikely that any

safeguard can eliminate or reduce the self-review threat to a level where independence is not compromised.

In relation to an *investment circular reporting engagement*, there is, for example, a self-review threat where a *firm* prepares an accountant's report on historical financial information which has been included in, or formed part of, financial statements which have already been subject to audit by the same *firm*. In such situations, where the two engagement teams are not independent of each other, the *engagement partner* evaluates the significance of the self-review threat created. If this is other than clearly insignificant, safeguards are applied, such as the appointment of an *engagement quality control reviewer* who has not been involved in the audit.

- ***management threat***

  Supporting ethical provision 2.1D requires that the *firm* and each *covered person* is not involved in the decision-taking of an *entity relevant to the engagement*. Paragraph 5.167R of Section 5 of Part B of this Ethical Standard requires in accordance with the EU Audit Regulation that, in the case of a *statutory audit* of a *public interest entity*, *non-audit services* shall not be provided that involve playing any part in the management or decision-making of an *audited entity*. Some activities that may be undertaken by the *firm* or its *staff* may give rise to a threat of being involved in making decisions that are the responsibility of management. A threat to integrity, objectivity and independence also arises where the *firm* provides *non-audit / additional services* and, based on that work, management are required to make judgments and take decisions. The persons conducting the service may become closely aligned with the views and interests of management and this may erode the distinction between the entity and the *firm*, in turn, impairing or calling into question the ability of the persons conducting an *engagement* to apply a proper degree of professional scepticism. The integrity and objectivity of the *firm* and *covered persons could be adversely affected* and their independence could be compromised.

  In determining whether a *non-audit / additional service* does or does not give rise to a management threat, the persons conducting the *engagement* consider whether there is '*informed management*'. *Informed management* exists when:

  - a member of management (or senior employee of the entity) has been designated by the entity to receive the results of the *non-audit / additional service* and has been given the authority to make any judgments and decisions of the type set out in paragraphs 1.24 and 1.25 that are needed;
  - that member of management has the capability to make independent management judgments and decisions on the basis of the information provided; and
  - the results of the *non-audit / additional service* are communicated to the entity and, where judgments or decisions are to be made by management they are supported by an objective analysis of the issues to consider and the entity is given the opportunity to decide between reasonable alternatives.

In the absence of such *informed management* it is unlikely that any other safeguards can eliminate a management threat or reduce it to a level where independence is not compromised.

In relation to an *investment circular reporting engagement*, a management threat arises, for example, when the *firm* undertakes work that involves making judgments and taking decisions, which are the responsibility of the management of the party responsible for issuing the *investment circular* containing the financial information or the party on whose financial information the *firm* is reporting in relation to:

- the transaction (for example, where it has been working closely with a company in developing a divestment strategy); or
- the financial information that is the subject of the *investment circular reporting engagement* (for example, deciding on the assumptions to be used in a profit forecast).

- ***advocacy threat***

  An advocacy threat arises when the *firm* undertakes work that involves acting as an advocate for an *entity relevant to an engagement*, and supporting a position taken by management in an adversarial or promotional context (for example, by acting as a legal advocate for the entity in litigation or a regulatory investigation, or undertaking an active responsibility for the marketing of an entity's shares). In order to act in an advocacy role, the *firm* has to adopt a position closely aligned to that of management. This creates both actual and perceived threats to the integrity, objectivity and independence of the *firm* and *covered persons*. For example, where the *firm*, acting as advocate, has supported a particular contention of management, it may be difficult for the persons conducting the *engagement* to take an impartial view of this in the context of an audit of the financial statements.

  Where the provision of a *non-audit / additional service* would require the *firm*, its partners or *staff* to act as an advocate for the entity in relation to matters that are material to the financial statements or other *subject matter information*, or to the *subject matter* of an *engagement*, it is unlikely that any safeguards can eliminate or reduce the advocacy threat to a level where independence would not be compromised.

- ***familiarity (or trust) threat***

  A familiarity (or trust) threat arises when the *firm* or a *covered person* predisposed to accept, or is insufficiently questioning of, the point of view of an *entity relevant to the engagement. Such threats may arise,* for example, where close personal relationships are developed with such an entity's personnel through long association with the entity.

- ***intimidation threat***

  An intimidation threat arises when the conduct of the *firm* or a *covered person* is influenced by fear or threats (for example, where the persons conducting the *engagement* encounter an aggressive and / or dominating individual).

These categories of threat may not be entirely distinct and certain circumstances may give rise to more than one type of threat. For example, where a *firm* wishes to retain the fee income from a large *entity relevant to an*

engagement, but encounters an aggressive or dominating individual, there may be a self-interest threat as well as an intimidation threat. Furthermore, relationships with *connected parties* of the entity (such as an *affiliate*) may give rise to similar threats.

1.30 Threats to the integrity and objectivity of the *firm* and *covered persons*, including threats that could compromise independence, may, for example, arise where the *firm* is appointed to provide *non-audit / additional services* for an entity not relevant to an *engagement* by the *firm*, but where an entity that is relevant to an *engagement* by the *firm* makes this decision. In such cases, even if the entity not relevant to an *engagement* by the *firm* pays the fee for the *non-audit / additional service* services, the *firm* considers the implication of the threats (especially the self-interest threat) that arise from the appointment.

1.31 Threats to the integrity or objectivity of the *firm* and *covered persons*, including threats that could compromise independence, may also arise where a *non-audit / additional service* is provided by the *firm* to a third party which is connected (through a relationship) to an *entity relevant to an engagement* by the *firm*, and the outcome of that service has a material impact on the financial statements of the entity or other *subject matter, information*, or on the *subject matter* of the *engagement*. For example, such threats may arise if the *firm* provides actuarial services to the pension scheme of an audited entity, which is in deficit and the *firm* subsequently gives an opinion on financial statements that include judgments given in connection with that service.

1.32 Similarly threats may arise where the *firm* or any *covered person* has a relationship with any *connected party* of the entity. Where any member of the *engagement team* is aware of such relationships, an assessment is made of whether independence is compromised (see also paragraph 1.37).

1.33 **The *firm* shall establish policies and procedures to require the *engagement partner* to identify and assess the significance of threats to the integrity and objectivity of the *firm* and *covered persons* on an individual and cumulative[10] basis, including any threats that may compromise independence:**

(a) when considering whether to accept or retain an *engagement*;

(b) when planning the *engagement*;

(c) when forming an opinion and signing the report on the financial statements or other *subject matter information*;[14]

(d) when considering whether to accept or continue to provide *non-audit / additional services* to an *engagement* by the *firm*; and

(e) when potential threats are reported to him or her.

1.34 An initial assessment of the threats to integrity, objectivity and independence is required when the *engagement partner* is considering whether to accept or retain an *engagement*. That assessment is reviewed and updated at the planning stage of each *engagement*. If consideration of whether to accept or

[14] In the case of *listed entities*, the auditor also assesses whether there is any threat to the auditor's integrity, objectivity or independence when discharging responsibilities in relation to preliminary announcements and when reporting on interim results.

retain an *engagement* does not arise, for example where responsibility for the *engagement* is assigned by legislation (e.g. for certain bodies in the public sector), an assessment of the threats to integrity, objectivity and independence is still undertaken. At the end of the *engagement* process, when forming an opinion on the financial statements or other *subject matter information* but before issuing the report, the *engagement partner* draws an overall conclusion as to whether all threats to integrity or objectivity including any that may compromise independence have been properly addressed on an individual and cumulative basis in accordance with this Ethical Standard. If, at any time, the *firm* is invited to provide *non-audit / additional services*, the *engagement partner* considers the impact this may have on the integrity, objectivity and independence of the *firm*, its partners or *staff*.

1.35 **When identifying and assessing threats to the integrity or objectivity of the *firm* or any *covered persons,* including any that may compromise independence , the *engagement partner* shall take into account current relationships with the entity (including *non-audit / additional services* provided and known relationships with *connected parties* of the entity) and with other parties in certain circumstances (see paragraph 1.37), that existed prior to the current *engagement* and any known to be in prospect following the current *engagement*.**

For an *investment circular reporting engagement*, the *relevant period* for consideration covers the period during which the engagement is undertaken and any additional period before that but subsequent to the balance sheet date of the most recent audited financial statements[15] of the *entity relevant to the engagement*. A *firm*'s procedures will include reference to records of past and current services / *engagements* whenever a new *investment circular reporting engagement* is proposed.

1.36 The requirement in paragraph 1.35 is because those prior and subsequent relationships may be perceived as likely to influence the *firm* or *covered persons* in the performance of the *engagement* or as otherwise compromising the integrity, objectivity or independence of the *firm* or *covered persons*.

1.37 Threats to the integrity or objectivity of the *firm* and *covered persons,* including those that may compromise independence, may arise where a service is provided by the *firm* to a third party which is connected (through a relationship) to an *entity relevant to an engagement* by the *firm*, and the outcome of that service has a material impact on the financial statements or other *subject matter information* of the entity. For example, if the *firm* provides actuarial services to the pension scheme of an *audited entity*, which is in deficit, and the *firm* subsequently gives an opinion on financial statements that include judgments given in connection with that service.

1.38 **Where the entity *relevant to an engagement* or a third party calls into question the integrity, objectivity or independence of the *firm* in relation to a particular entity, the *Ethics Partner* shall carry out such investigations as may be appropriate and determine what action, if any, is needed.**

[15] In the case of newly incorporated clients (not part of an established group of companies), where there has been no financial statement audit, this period is from the date of incorporation.

Investment Circular Reporting Engagements

1.39 When identifying threats to integrity or objectivity including any that could impair independence, *reporting accountants* consider circumstances and relationships with a number of different parties. For example, the *entities relevant to the engagement* may constitute one or more parties, dependent on the circumstances of the transaction which is the subject of the *investment circular*[16]. Where the party responsible for issuing the *investment circular* is different from the party whose financial information is included in the *investment circular*, the *reporting accountant* makes an assessment of independence with respect to each of these parties, applying the alternative procedures set out in paragraph 1.40 as necessary.

1.40 Where either:

- an *investment circular reporting engagement* is undertaken to provide a report on the financial information relating to an entity audited by the *firm* but the *reporting accountant's* report is to be published in an *investment circular* issued by another entity that is not an entity audited by the *firm*; or
- the *reporting accountant's* report is to be published in an *investment circular* issued by an entity audited by the *firm* but the *reporting accountant's* report is on financial information relating to another entity that is not an entity audited by the *firm*,

it may not be practicable in the time available to identify all relationships and other services or engagements recently undertaken by the *firm* for the non-audit *entity relevant to the engagement* and its *significant affiliates*. In such instances the *reporting accountant* undertakes those enquiries[17] that are practical in the time available into the relationships and other services / engagements that the *firm* has with the non-audit *entity relevant to the engagement* and, having regard to its obligations to maintain confidentiality, addresses any identified threats. Having done so, the *reporting accountant* discloses to those charged with governance of the issuing *entity relevant to the engagement* that a consideration of all known threats has been undertaken and, where appropriate, safeguards applied, but that this does not constitute a full evaluation of all relationships and other services provided to the non-audit *entity relevant to the engagement*.

1.41 **In addition to considering independence with respect to each *entity relevant to the engagement*, the *reporting accountant* shall also consider relationships with other parties who are connected with the *investment circular*. These parties shall include the sponsor or nominated advisor, other parties from whom, in accordance with the engagement letter, the *reporting accountant* takes instructions and**

[16] For example, where a report on a target company's financial statements is prepared by that company's auditors for inclusion in the acquiring company's *investment circular*.

[17] For example, these enquiries are likely to include reviewing the list of engagements recorded in the *firm's* accounting systems and an enquiry of individuals within the *firm* who are responsible for maintaining such systems as to whether any confidentially coded engagements could be relevant.

other entities directly involved in the transaction which is the subject of the *investment circular*.[18]

1.42 The *reporting accountant* considers the circumstances involved and uses judgment to assess whether it is probable that an objective, reasonable and informed third party would conclude that the *reporting accountant's* integrity or objectivity is impaired and independence is compromised as a result of relationships held with any of these parties.

1.43 In the case of established financial institutions or advisers, the *reporting accountant* may have extensive relationships with these parties, including for the provision of other services or the purchase of goods and services in the ordinary course of business that are not material to any *entity relevant to the engagement*. These relationships will not generally give rise to a significant threat to the *reporting accountant's* integrity or objectivity.

1.44 Relationships with other parties who are connected with the *investment circular* which are outside the ordinary course of business or which are material to any *entity relevant to the engagement* are more likely to give rise to a significant threat to the *reporting accountant's* integrity or objectivity. Consideration of the threats to the *reporting accountant's* integrity or objectivity in relation to other entities will primarily be concerned with matters that could give rise to self-interest and intimidation threats, for example:

- where there is financial dependence on the relationship with the other party arising from fees (including any contingent element) for *investment circular reporting engagements* undertaken by the *firm* as a result of connections with the other parties;
- joint ventures or similar relationships with the other party or with a senior member of their management;
- significant purchases of goods or services which are not in the ordinary course of business or are not on an arm's length basis;
- personal relationships between *engagement team* members and individuals in senior positions within the other party; or
- large direct financial interests in, or loans made by, the other party.

Identification and Assessment of Safeguards

1.45 **If the *engagement partner* identifies threats to the integrity or objectivity of the *firm* or *covered persons*, including any that could compromise independence, he or she shall identify and assess the effectiveness of the available safeguards and apply such safeguards as are sufficient to eliminate the threats or reduce them to a level where independence would not be compromised.**

1.46 The nature and extent of safeguards to be applied depend on the significance of the threats. Where a threat is clearly insignificant, no safeguards are needed.

[18] Where such entities are part of a complex group or corporate structure, the *reporting accountant* considers issues relating to the wider group and not just the entity directly involved in the transaction.

1.47 Other sections of this Ethical Standard address specific circumstances that can create threats to integrity or objectivity or could impair the independence of the *firm* or *covered persons*. They give examples of safeguards that can, in some circumstances, eliminate the threat or reduce it to level where it would not compromise independence. In some circumstances, the *firm* either does not accept or withdraws from the *engagement* as appropriate or, in the case of threats arising from the provision of *non-audit / additional services*, does not undertake or withdraws from the *non-audit / additional service*.

1.48 This Ethical Standard contains certain additional requirements or prohibitions that apply only in the case of *engagements* for *public interest entities* (PIEs) or *listed entities or in both cases*:

- *Public interest entities* only: paragraphs 1.75R, 2.39(b)(i), 3.10R, 3.18R, 3.19R, 4.34R, 5.167R, 5.168R, 5.170R, 5.171R, 5.172R, 5.173R
- *Listed entities* only (including such entities that are PIEs) other than *SME listed entities*: paragraphs 5.67(a), 5.74(a), 5.85(a), 5.92, 5.104(a), 5.111, 5.148, 5.155(a)
- *Listed entities* only (including *SME listed entities* and *listed entities* that are PIEs): paragraphs 3.11, 5.47
- *Listed entities* (including *SME listed entities*) and *public interest entities*: paragraphs 1.66, 3.20, 3.21, 4.25, 4.37, 4.42, 4.47

These additional requirements also apply where regulation or legislation requires that the *engagement* for an entity is conducted in accordance with the standards or ethical requirements that are applicable to *engagements* for *public interest entities* or other *listed entities*.

1.49 **The *firm* shall establish policies and procedures which set out the circumstances in which those additional requirements listed in paragraph 1.48 that apply to *public interest entities* or to *listed entities* or both are applied to other *engagements*. Where such requirements are applied to a *public interest entity* or to a *listed entity* or both, or to an other entity under such policies and procedures, the *engagement partner* shall ensure that fact is communicated to those charged with governance.**

1.50 Such policies and procedures take into consideration any additional criteria set by the *firm*, such as the nature of the entity's business, its size, the number of its employees and the range of its stakeholders. For example, a *firm* may decide to extend the additional requirements to *engagements* for certain large private sector entities.

1.51 **The *engagement partner* shall not accept or shall not continue an *engagement* if he or she concludes that any threats to the integrity or objectivity of the *firm* or *covered persons* cannot be reduced to a level where independence would not be compromised.**

1.52 Where an objective, reasonable and informed third party would regard ceasing to act as the provider of an *engagement* as detrimental to the shareholders of the *audited entity* (or equivalent intended users of the audit or other assurance engagement report) of, or would otherwise be contrary to the public interest, then resignation may not be immediate. However, the *firm* discloses full details of the position to those charged with governance of the

entity and, if applicable (e.g. for an *investment circular reporting engagement*), other entities and persons the *firm* is instructed to advise, and establishes appropriate safeguards.

Other Firms Involved Engagements

1.53 In order to use the work of another *firm* (including *network firms*) for the purpose of an *engagement*, the lead *firm* for the *engagement* has to be satisfied that such another *firm* is independent of each *entity relevant to the engagement* in accordance with supporting ethical provision 2.4 of this Ethical Standard.

1.54 The *engagement partner* obtains sufficient appropriate evidence[19] as necessary to be satisfied that *network firms* (whether or not involved in the *engagement*), and third party *firm*s whose work is used in the conduct of the *engagement*, are independent of each *entity relevant to the engagement* in accordance with supporting ethical provision 2.4. If the *engagement partner* is not able to obtain such evidence, or obtains evidence that the other *firm* does not meet the relevant independence requirements, the *engagement team* cannot use the work of that other *firm* for the purpose of the *engagement*. Work for the purpose of the *engagement* may be undertaken, where possible, by partners and *staff* from the *firm* performing the *engagement* or by another *firm* which is independent of each *entity relevant to the engagement* as required.

1.55 In the case of a *public interest entity* or an other *listed entity*, the *engagement partner* establishes that the *entity relevant to the engagement* has communicated its policy[20] on the use of *firm*s to supply *non-audit / additional services* to its *affiliates* and obtains confirmation that the other *firm*s involved in the engagement will comply with this policy.

Engagement Quality Control Review

1.56 Requirements for engagement quality control review are established in ISQC (UK) 1 (Revised June 2016).

Overall Conclusion

1.57 **At the end of the *engagement* process, when forming an opinion to be reported, or otherwise reporting on the work undertaken, but before issuing the report, the *engagement partner* shall reach an overall conclusion that any threats to integrity or objectivity including any that could impair independence on an individual and cumulative basis have been properly addressed in accordance with this Ethical Standard. If the *engagement partner* cannot make such a conclusion, he or she shall not**

---

[19] For an audit, ISA (UK) 600 (Revised June 2016) *'Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)'* requires that the group engagement team shall obtain an understanding of whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent.

[20] The UK Corporate Governance Code requires audit committees to develop the company's policy on the engagement of the external auditor to supply *non-audit services*.

report and the *firm* shall resign or otherwise withdraw from the *engagement* unless not permitted to do so by law or regulation.

1.58 In addition to assessing individual threats to integrity or objectivity including any that could impair independence of the *firm* or *covered persons*, the *engagement partner* assesses the cumulative impact of all the threats identified so as to reach a conclusion that the threats identified, when viewed individually and cumulatively, have been eliminated or reduced to a level where independence would not be compromised.

1.59 If the *engagement partner* remains unable to conclude that any individual threats to integrity or objectivity including any that could impair independence, or that all such threats viewed on a cumulative basis, have been eliminated or reduced to a level where independence would not be compromised, or if there is a disagreement between the *engagement partner* and the *engagement quality control reviewer*, he or she consults the *Ethics Partner* / Function.

1.60 In concluding on these matters, the *engagement partner* is entitled to rely on the completeness and accuracy of the data developed by the *firm*'s systems relating to independence (for example, in relation to the reporting of financial interests by *staff*), unless informed otherwise by the *firm*. In this context 'data' does not include any judgments made about specific matters identified as the responsibility of the *engagement partner* in this Ethical Standard.

Communication with Those Charged With Governance

1.61 **The *engagement partner* shall ensure that those charged with governance of each *entity relevant to an engagement*, and, in the case of an *investment circular reporting engagement*, any other persons or entities the *firm* is instructed to advise, are appropriately informed on a timely basis of all significant facts and matters that may bear upon the integrity, objectivity and independence of the *firm* or *covered persons*.**

1.62 The audit committee, where one exists, is usually responsible for oversight of the relationship of an *entity relevant to the engagement* with the *firm* and of the conduct and outcome of the *engagement*. It therefore has a particular interest in being informed about the *firm*'s ability to express an objective opinion on the financial statements or other *subject matter information* or on the *subject matter* of the *engagement*. Where there is no audit committee, or where its responsibilities do not extend to other *public interest assurance engagements*, this role may be undertaken by another body with equivalent responsibilities or by the board of directors.[21]

1.63 The aim of these communications is to ensure full and fair disclosure by the *firm* to those charged with governance of each *entity relevant to the engagement* on matters in which they have an interest. These matters will generally include the key elements of the *engagement partner's* consideration of integrity, objectivity and independence, such as:

[21] Where there is no audit committee or equivalent body, references in this Ethical Standard to communication with the audit committee are to be construed as including communication with the board of directors.

- the principal threats, if any, to integrity or objectivity including any that could impair independence identified by the *firm*, including consideration of all relationships between the entity, its *affiliates* and directors and the *firm*;
- any safeguards adopted and the reasons why they are considered to be effective, including any independent partner review;
- the overall assessment of threats and safeguards;
- information about the general policies and processes within the *firm* for maintaining integrity, objectivity and independence.

1.64 For an *investment circular reporting engagement*, if applicable, communications are made also to those from whom, in accordance with the engagement letter, the *firm* takes instructions on matters in which they have an interest. It may be that all of the parties to the engagement letter wish to be informed about all significant facts and matters that bear upon the integrity, objectivity and independence of the *firm* and *covered persons*. In other cases, however, the parties to the engagement letter (other than an *entity relevant to the engagement*) may not wish to be directly involved and may appoint one or more of their number to review these matters on their behalf. At the time of appointment, the *engagement partner* ensures that it is clear in the engagement letter to whom these communications are provided. If no such provision is included in the engagement letter, disclosures will be made to all those from whom, in accordance with the engagement letter, the *firm* takes instructions.

1.65 Communications between the *firm* and those charged with the governance of each *entity relevant to the engagement* and, in the case of an *investment circular reporting engagement*, any other persons the *firm* may be instructed to advise, will be needed at the planning stage and whenever significant judgments are made about threats to integrity, objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting to provide *non-audit / additional services*.

1.66 **In the case of *public interest entities,* and *listed entities*, *relevant to an engagement* other than an *investment circular reporting engagement*, the *engagement partner* shall ensure that the audit committee is provided with:**

(a) a written disclosure of relationships (including the provision of *non-audit / additional services*) that may bear on the integrity, objectivity or independence of the *firm* or *covered persons*. This shall have regard to relationships with the entity, its directors and senior management, its *affiliates*, and its *connected parties*, and the threats to integrity or objectivity, including those that could compromise independence, that these create. It shall also detail any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable the integrity, objectivity and independence of the *firm* and each *covered person* to be assessed;

(b) details of *non-audit / additional services* provided and the fees charged in relation thereto;

(c) written confirmation that the *firm* and each *covered person* is independent;

(d) details of any inconsistencies between this Ethical Standard and the policy of the *entity* for the provision of *non-audit / additional services* by the *firm* and any apparent breach of that policy.

(e) an opportunity to discuss independence issues.

1.67 **For an *investment circular reporting engagement*, the *engagement partner* shall ensure those charged with governance of each issuing *entity relevant to the engagement*, and any other persons or entities the *firm* is instructed to advise are provided in writing with:**

(i) details of all relationships that the *reporting accountant* considers may reasonably be thought to bear on the integrity, objectivity and independence of the *reporting accountant*, having regard to its relationships with each *entity relevant to the engagement*, its directors and senior management and its *affiliates*. This shall include significant services previously provided by the *firm* and *network firms* involved in the *investment circular reporting engagement* to each *entity relevant to the engagement* and its *significant affiliates*.

(ii) disclosure of:

- **all relationships that give rise to a threat to integrity or objectivity between the *reporting accountant* and:**
  - **the sponsor and such other parties from whom the *reporting accountant* takes instructions. Where a party to the engagement letter is an established financial institution or adviser, a generic disclosure that the *firm* has extensive relationships entered into in the ordinary course of business with these parties is sufficient with specific disclosure only being made in the case of relationships which are outside the ordinary course of business or which are material to any party;**
  - **other entities directly involved in the transaction which is the subject of the *investment circular*;**
- **whether the total amount of fees that the *reporting accountant* is likely to charge an *entity relevant to the engagement* and its *significant affiliates* for the provision of services relating to the transaction which is the subject of the *investment circular* during the *relevant period* is greater than 5% of the fee income of the *firm* in the *relevant period* or the part of the *firm* by reference to which the *engagement partner's* profit share is calculated during the *relevant period*; and**
- **the related safeguards that are in place and why they are considered effective;**

(iii) confirmation that the *firm* and each *covered person* is independent and, where relevant, the circumstances contemplated in paragraph 1.40 exist and that a consideration of all known threats and safeguards has been undertaken, but this does not constitute a full

evaluation of all business relationships and other services provided to the entity.

1.68 The most appropriate time for these final written confirmations of independence is usually at the conclusion of the *engagement*.

1.69 The disclosure in writing of all relationships with the *entity relevant to the engagement*, and its directors and senior management and its *affiliates*, includes all services provided by the *firm* and its network to the entity, its directors and senior management and its *affiliates*, and other services provided to other known *connected parties* that may reasonably be thought to bear on the integrity, objectivity or independence of the *firm* or *covered persons* and the related safeguards that are in place.

1.70 For an *audit engagement*, the *engagement partner* ensures that the total amount of fees that the *firm* and its *network firms* have charged to the *audited entity* and its *affiliates* for the provision of services during the reporting period, analysed into appropriate categories are disclosed. The Appendix to this Ethical Standard contains an illustrative template for the provision of such information to an audit committee[22]. Separately, the auditor provides information on any contingent fee arrangements[23], the amounts of any future services which have been contracted, and details of any written proposal to provide *non-audit services* that has been submitted.

1.71 The written confirmation that the *firm* and each *covered person* is independent indicates that the *firm* considers that it complies with this Ethical Standard and that, in the *engagement partner's* professional judgment, the integrity, objectivity and independence of the *firm* and each *covered person* is not compromised. If it is not possible to make such a confirmation, the communication will include any concerns that the integrity, objectivity or independence of the *firm* or any *covered person* may be compromised (including instances where the *engagement partner* considers that the independence of an other *firm* involved in the *engagement* is compromised) and an explanation of the actions which necessarily follow from this.

Documentation

1.72D **The *firm* shall document in the *engagement* working papers all significant threats to the integrity or objectivity, including any that could impair independence, of the *firm* and all *covered persons* as well as the safeguards applied to mitigate those threats and why they mitigate the threats.** [AD 22.3]

1.73 **The *engagement partner* shall ensure that his or her consideration of the integrity, objectivity and independence of the *firm* and *covered persons* is appropriately documented on a timely basis.**

---

[22] When considering how to present this analysis of fees, the auditor takes account of any applicable legislation.

[23] Paragraph 4.25 of Section 4 of Part B of this Ethical Standard requires the engagement partner to disclose to the audit committee, in writing, any contingent fee arrangements for *non-audit / additional services* provided by the *firm* or its *network firms*.

1.74D **Before accepting or continuing an *engagement*, the *firm* shall assess and document the following:**

- **whether it meets the ethical outcomes of the overarching principles and supporting ethical provisions, and complies with the requirements, of this Ethical Standard;**
- **whether there are threats to its integrity, objectivity or independence and the safeguards applied to mitigate those threats and why they mitigate the threats;** [AD 22b.1)

1.75R **Before accepting or continuing an engagement for a *statutory audit* of a *public interest entity*, ~~a statutory auditor or~~ an *audit firm* shall assess and document , in addition to the provisions of ~~Article 22b of Directive 2006/43/EC~~ paragraph 1.74D above, the following:**

(a) whether ~~he, she or~~ it complies with the requirements of Articles 4[24] and 5[25] of ~~this~~ the EU Audit Regulation;

(b) whether the conditions of Article 17[26] of ~~this~~ the EU Audit Regulation are complied with;

(c) ~~without prejudice to Directive 2005/60/EC, the~~ the integrity of the members of the supervisory, administrative and management bodies of the *public interest entity*. [AR 6.1]

1.76 The requirement to document these issues contributes to the clarity and rigour of the *engagement partner's* thinking and the quality of his or her judgments. In addition, such documentation provides evidence that the *engagement partner's* consideration of the integrity, objectivity and independence of the *firm* and *covered person* was properly performed and, for *public interest entities* and other *listed entities* and where otherwise applicable, provides the basis for review by the *engagement quality control reviewer*.

1.77 Matters to be documented[27] include all key elements of the process and any significant judgments concerning:

- threats identified, other than those which are clearly insignificant, and the process used in identifying them.

  For an *investment circular reporting engagement* this includes threats in relation to each *entity relevant to the engagement*, those from whom, in accordance with the engagement letter, the *reporting accountant* takes instructions and other entities directly involved in the transaction which is the subject of the *investment circular*;

[24] See Section 4, paragraphs 4.6R, 4.7R and 4.34R – 4.36R, of Part B of this Ethical Standard.

[25] See Section 5, paragraphs 5.167R – 5.173R, of Part B of this Ethical Standard.

[26] See Section 3, paragraphs 3.9, 3.10R, 3.18R, 3.19R, of Part B of this Ethical Standard.

[27] The necessary working papers can be combined with those prepared pursuant to paragraph 24 of ISA (UK) 220 (Revised June 2016) *'Quality Control for an Audit of Financial Statements'*, which requires that: "The auditor shall include in the audit documentation conclusions on compliance with independence requirements that apply to the *audit engagement*, and any relevant discussions with the *firm* that support these conclusions."

- safeguards adopted and the reasons why they are considered to be effective;
- review by an *engagement quality control reviewer* or an independent partner;
- overall assessment of threats and safeguards on an individual and cumulative basis, and
- communication with those charged with governance and, where applicable, any other persons or entities the *firm* is instructed to advise.

Effective Date

1.78 This Ethical Standard becomes effective on 17 June 2016.

1.79 *Firm*s may complete *engagements* relating to periods commencing before 17 June 2016 in accordance with existing ethical standards, putting in place any necessary changes in the subsequent engagement period.

1.80 Engagements to provide tax services wholly or partly on a *contingent fee basis* to a *listed entity relevant to an engagement* that is not an *SME listed entity* (see paragraph 5.85 of Section 5 of Part B of this Ethical Standard), or a *significant affiliate* of such an entity, entered into before 17 June 2016 may continue until currently active services are completed in accordance with the engagement terms as long as:

- the engagement was permitted under the existing ethical standards; and
- safeguards established continue to be applied

A 'currently active service' is one where the entity has already asked the *firm* for advice in relation to a particular matter and the *firm* has commenced work in relation to that matter. It does not include advice on future matters that may, for example, be provided for in an open ended engagement/contract.

Section 2 – Financial, Business, Employment and Personal Relationships

Financial Relationships

General Considerations

2.1 A financial interest in an entity is an interest in a *financial instrument* issued, guaranteed or otherwise supported by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such an interest.

2.2 A financial interest may be:

(a) a 'direct financial interest', held by way of

(i) direct ownership of the *financial instrument*; or

(ii) a 'direct beneficial interest' – i.e. an interest held through an intermediary which is controlled by that person holding the financial interest or where that person has the ability to influence the intermediary's investment policy.

For example, a direct beneficial interest may exist by virtue of the person being an identified potential beneficiary under a trust, or under a will relating to an estate, where the trust or estate holds an underlying direct financial interest and the person has such control or influence over the trust or estate; or

(b) an 'indirect financial interest', held through an intermediary (other than an intermediary over which the person holding the financial interest has control or influence as described in (a)).

For example, an indirect financial interest may be held through a diversified collective investment scheme, such as an authorised unit or investment trust, an open ended investment company, managed funds such as pensions or life insurance or other similar investment schemes with diversified investments, diversified investors and independent investment managers.

2.3D **For an *engagement* other than an *investment circular reporting engagement*, save where otherwise required when the circumstances contemplated in paragraphs 2.7, 2.9, 2.12, 2.18 and 2.20 apply, and always subject to the prohibitions on holding financial interests set out in paragraph 2.4D, the *firm*, each partner in the *firm*, each *covered person* and any *persons closely associated* with any such partner or *covered person*, shall not hold:**

(a) any direct financial interest in an *entity relevant to the engagement* or an entity that is an *affiliate* of such an entity; or

(b) any indirect financial interest in an *entity relevant to the engagement* or any entity that is an *affiliate* of such an entity, that is material to the *firm*, or the person or the intermediary; or

(c) any other indirect financial interest in an *entity relevant to the engagement* or an entity that is an *affiliate* of such an entity, where the person holding it has both:

(i) the ability to influence the investment decisions of the intermediary; and

(ii) actual knowledge of the existence of the underlying holding of a direct financial interest by the intermediary. [AD22.4]

2.4D **The *firm*, each of the *firm's key audit partners* and each of the *firm*'s *directly involved covered persons* for any *engagement* other than an *investment circular reporting engagement*, and any *persons closely associated* with the *firm* or any such partner or *covered person*, shall not:**

(a) hold any material *financial interest* (other than an indirect financial interest held through a diversified collective investment scheme) in, or engage in any transaction in, any *financial instrument* of any *entity relevant to an engagement* in the *area* of *activity*[28] in which they (or in the case of a *person closely associated*, the *area of activity* in which the *firm, key audit partner* or *covered person* with whom they are closely associated) are involved relating to *engagements* other than *investment circular reporting engagements*; or

(b) hold any financial interest, other than an indirect financial interest held through a diversified collective investment scheme, in:

(i) any *entity relevant to an engagement* other than an *investment circular reporting engagement* for which they are a *directly involved covered person*; or

(ii) an entity which is an *affiliate* of such an entity; or

(iii) any other entity otherwise related to such an entity in circumstances where holding such a financial interest may cause, or may be generally perceived as causing, a conflict of interest;

or, if a person holds such a financial interest they shall be excluded from any role by virtue of which they would be a *covered person* for any such *engagement*. [AD 22.2]

2.5 **For an *investment circular reporting engagement*, the *firm* and each *covered person*, and *persons closely associated with them*, shall not hold during the engagement period:**

(a) a direct financial interest; or

[28] In relation to a *key audit partner* or other *covered person*, or a *person closely associated* with such a partner or *covered person*, any *engagements* for which the *covered person* is a *directly involved covered person* and any other *engagements*, in relation to which the *engagement partner* practices in the same office or business unit as the *covered person*.

(b) an indirect financial interest that is material to the *firm* or to the individual or to the intermediary; or

(c) any other indirect financial interest where the person holding it has both (i) the ability to influence the investment decisions of the intermediary, and (ii) actual knowledge of the of the existence of the underlying investment;

in any *entity relevant to the engagement* or in an entity that is an *affiliate* of, or otherwise related to, such an entity.

2.6 The requirements in paragraphs 2.3D to 2.5 have been established because threats to integrity, objectivity and independence in relation to *engagements*, where the *firm* or other persons have direct or indirect financial interests in an *entity relevant to an engagement* in the circumstances referred to in those paragraphs, are such that it is considered that no safeguards can eliminate them or reduce them to a level where they would not compromise independence, and they are therefore precluded.

2.7 Except where prohibited in accordance with paragraph 2.4D, where a *person closely associated* with a partner in the *firm* who is not a *covered person* for an *engagement* of the *firm*, has a financial interest in any *entity relevant to the engagement*, or in any *affiliate* of such an entity, as a consequence of:

- the compensation arrangements of that closely associated person (for example, a share option scheme, where the shares have not vested); or
- a decision made, or a transaction undertaken, by an entity with whom that closely associated person has a contractual business or employment arrangement (for example, a partnership agreement);

such financial interests are not generally considered to threaten integrity or objectivity or to compromise independence in relation to the *engagement*. However, where such interests are significant or the relevant partner or other person referred to in paragraph 2.4D has close working contacts with the *engagement team*, the *Ethics Partner*/Function considers whether any safeguards need to be put in place.

2.8 For the purposes of paragraph 2.3D, where financial interests in a diversified collective investment scheme that is an *entity relevant to an engagement* of the *firm*, or an *affiliate* of such an entity, are held by a partner in the *firm*, or by a *person closely associated* with such a partner and that partner is not a *covered person* for such an *engagement,* such interests are to be treated as indirect financial interests. Such interests can therefore be held as long as:

(a) they are not material to the individual; and

(b) the individual has no influence over the investment decisions of the entity.

2.9 Except where prohibited in accordance with paragraph 2.4D, for the purposes of paragraph 2.3D, where a person who is a *covered person*, or any *partner* in the *firm,* or any *person closely associated* with them, is a member or shareholder of any *entity that is relevant to an engagement*, as a result of the entity's membership or equivalent requirements, the *firm* should ensure that

no more than the minimum number of shares necessary to comply with the requirement are held and should assess whether this financial interest is material to either the entity or the person holding the interest. Disclosure of such interests should be made to those charged with governance of such an entity, in accordance with paragraph 1.61 of Section 1 of Part B of this Ethical Standard.

2.10 Where the *firm*, a partner or a *covered person* holds any financial interests that they would not be permitted to hold, or engages in any transaction in *financial instruments* that they would not be permitted to engage in, in breach of the requirements in paragraphs 2.3D, 2.4D(a) or 2.5 in circumstances other than those contemplated in paragraphs 2.11 or 2.12, either: the entire financial interest is disposed of; or, where only a material holding is not permitted, a sufficient amount of the financial interest is disposed of so that the remaining interest is no longer material. In addition, in the case of a person, they are excluded from any role by virtue of which they would be a *covered person*; and, where the holding or transaction is not permitted in accordance with paragraph 2.4D(a) they are excluded from any role by virtue of which they would be operating in their *area* of *activity relating to engagements* other than *investment circular reporting engagements* that encompasses any *engagements* for entities in which the financial interests were held, or in whose *financial instruments* the person engaged in transactions. In addition, in the case of a *firm*, the *firm* does not accept (or withdraws from) the *engagement*.

2.11 In relation to an *investment circular reporting engagement*, if the existence of the transaction which is connected with the *investment circular* is price sensitive information then disposal of any financial interest in accordance with paragraph 2.10 may not be possible and the *firm* either does not accept the *engagement* or the relevant individuals are not included in the *engagement team*. Where a person holding the financial interests specified would otherwise be a *covered person,* that person is excluded from any role by virtue of which they would be a *covered person* for the purposes of the particular *investment circular reporting engagement*.

2.12 Where a person who is joining the *firm* as a partner or *staff* member, or any *person closely associated* with them, has any financial interests acquired before the person joined the *firm* that they would not be permitted to hold in accordance with the requirements in paragraphs 2.3D or 2.4D, they should:

(i) Where they would not be permitted to hold the financial interests in accordance with paragraph 2.4D, dispose of those financial interests prior to the person joining the *firm*;

(ii) Where they would not be permitted to hold the financial interests in accordance with paragraph 2.3D, disposed of those financial interests prior to, or immediately when, the person joins the *firm*, unless:

(a) the person joining the *firm* is not able to influence the affairs of any *entity relevant to an engagement* in which the interests are held; and

(b) either there is no market for such interests, or the individual does not have the power to sell or to direct the sale of the interest; and

(c) the financial interests are not held in an *entity relevant to an engagement* in relation to which the person joining the *firm*:

- is a *covered person*; or
- works in the same part of the *firm* as the *engagement partner* for any such *engagement*; or
- is involved in the provision of a *non-audit / additional service* to any such entity or in an entity that is an *affiliate* of such an entity;

(iii) Where not disposed of prior to, or immediately when, the person joins the *firm*, financial interests that the person would not be permitted to hold in accordance with paragraph 2.3D must be disposed of as soon as possible after the individual holding them becomes able to make a disposal. The *firm* ensures that:

(a) the deferral of the disposal of such financial interests is approved by the *Ethics Partner*/Function;

(b) a record is maintained of such individuals and interests, including a description of the circumstances; and

(c) this information is communicated to the relevant *engagement partner*.

2.13 Where any financial interest specified in paragraph 2.3D is acquired unintentionally, as a result of an external event (for example, inheritance, gift, or merger of *firms* or companies), the disposal of the financial interest is required immediately, or as soon as possible after the relevant person has actual knowledge of, and the right to dispose of, the interest. More specific requirements are set out in paragraph 1.27D of Section 1 of Part B of this Ethical Standard, that apply in circumstances where during the period covered by the financial statements an *audited entity* is acquired by, merges with, or acquires another entity.

2.14 Where the disposal of a financial interest in accordance with paragraphs 2.4D(b), 2.10, 2.11, 2.12 or 2.13 does not take place immediately, the *firm* should adopt safeguards to preserve integrity, objectivity and independence until the financial interest is disposed of. These may include the temporary exclusion of a *covered person* from any role by virtue of which they would be a *covered person* for the *engagement*, or (where continued participation in the *engagement* is not otherwise precluded in accordance with paragraphs 2.3D or 2.4D) a review of the relevant person's work by a partner having sufficient experience and authority to fulfil the role who is not involved in the *engagement*.

2.15 Where the *firm* or one of the individuals specified in paragraph 2.3D or 2.5 holds an indirect financial interest but does not have both:

(a) the ability to influence the investment decisions of the intermediary; and

(b) actual knowledge of the existence of the underlying investment in the *entity relevant to the engagement*;

there may not be a significant threat to integrity or objectivity and independence. For example, where the indirect financial interest takes the form of an investment in a pension fund, the composition of the funds and the size and nature of any underlying investment in the entity may be known but

there is unlikely to be any influence on investment decisions, as the fund will generally be managed independently on a discretionary basis. In the case of an 'index tracker' fund, the investment in the entity is determined by the composition of the relevant index and there may be no threat to integrity or objectivity. As long as the person holding the indirect interest is not directly involved in an *engagement* involving the intermediary, nor able to influence the individual investment decisions of the intermediary, any threat to integrity or objectivity and any impairment of independence may be regarded as clearly insignificant.

2.16 Where the *firm* or one of the individuals specified in paragraph 2.4D or 2.5 holds a beneficial interest in a properly operated 'blind' trust, they are (by definition) completely unaware of the identity of the underlying investments. If these include an investment in the entity, this means that they are unaware of the existence of an indirect financial interest. In these circumstances, any threat to integrity or objectivity and any impairment of independence may be regarded as clearly insignificant.

2.17 **Where a partner in the *firm* or a *covered person* becomes aware that a *close family* member holds any financial interest specified in paragraphs 2.3D, 2.4D or 2.5, that person shall report the matter to the *engagement partner* to take appropriate action. If it is a *close family* member of the *engagement partner*, or if the *engagement partner* is in doubt as to the action to be taken, the *engagement partner* shall resolve the matter through consultation with the *Ethics Partner*/Function.**

Financial Interests Held as Trustee

2.18 Where a direct or an indirect financial interest in an *entity relevant to the engagement* or in any *affiliate* of such an entity is held in a trustee capacity by a *covered person*, or by a *person closely associated* with them, a self-interest threat may be created because either the existence of the trustee interest may influence the conduct or outcome of the *engagement* or the trust may influence the actions of the entity. Accordingly, such a trustee interest is not held when:

- the relevant person is an identified potential beneficiary of the trust; or
- the financial interest held by the trust in the entity is material to the trust; or
- the trust is able to exercise significant influence over the entity or an *affiliate* of the entity; or
- the relevant person has significant influence over the investment decisions made by the trust, in so far as they relate to the financial interest in the entity; or
- such a holding is otherwise precluded by the requirements in paragraph 2.4D.

2.19 Where it is not clear whether the financial interest in the entity held by the trust is material to the trust or whether the trust is able to exercise significant influence over the entity, the financial interest is reported to the *Ethics Partner*/Function, so that a decision can be made as to the steps that need to be taken.

2.20 A direct or an indirect financial interest in the entity or its *affiliates* held in a trustee capacity by the *firm* or by a partner in the *firm* who is not a *covered person* or a *person closely associated* with them, cannot be held when the *firm* or relevant person is an identified potential beneficiary of the trust.

Financial Interests Held by Firm Pension Schemes

2.21 Where the pension scheme of a *firm* has a financial interest in an *entity relevant to an engagement*, or in the entity's *affiliates*, and the *firm* has any influence over the trustees' investment decisions (other than indirect strategic and policy decisions), the self-interest threat created is such that no safeguards can eliminate it or reduce it to a level where independence is not compromised. In other cases (for example, where the pension scheme invests through a collective investment scheme and the *firm's* influence is limited to investment policy decisions, such as the allocation between different categories of investment), the *Ethics Partner* considers the acceptability of the position, having regard to the materiality of the financial interest to the pension scheme.

Loans and Guarantees

2.22 Where *firms*, *covered persons* or *persons closely associated* with them:

(a) accept a loan[29] or a guarantee of their borrowings from an *entity relevant to the engagement*; or

(b) make a loan to or guarantee the borrowings of an *entity relevant to the engagement*,

a self-interest threat and an intimidation threat to integrity or objectivity can be created and independence may be compromised. In a number of situations, as in the case of those addressed in paragraphs 2.23, 2.24 and 2.25, it is considered that no safeguards can eliminate these threats or reduce them to a level where independence is not compromised and accepting and making loans in those circumstances is therefore precluded.

2.23 ***Firms*, *covered persons* and *persons closely associated* with them shall not make a loan to, or guarantee the borrowings of, an *entity relevant to the engagement*, or the *affiliates* of such an entity, unless this represents a deposit made with a bank or similar deposit taking institution in the ordinary course of business and on normal business terms.**

2.24 ***Firms* shall not accept a loan from, or have their borrowings guaranteed by an *entity relevant to an engagement*, or the *affiliates* of such an entity, unless:**

(a) the entity is a bank or similar deposit taking institution; and

(b) the loan or guarantee is made in the ordinary course of business on normal business terms; and

(c) the loan or guarantee is not material to both the *firm* and the entity.

[29] For the purpose of this Ethical Standard, the term 'loan' does not include ordinary trade credit arrangements or deposits placed for goods or services, unless they are material to either party (see paragraph 2.29).

2.25 ***Covered persons* and *persons closely associated* with them shall not accept a loan from, or have their borrowings guaranteed by, the *entity relevant to the engagement*, or the *affiliates* of such an entity, unless:**

(a) the entity is a bank or similar deposit taking institution; and

(b) the loan or guarantee is made in the ordinary course of business on normal business terms; and

(c) the loan or guarantee is not material to the entity.

2.26 Loans by an *entity relevant to an engagement* that is a bank or similar institution to a *covered person*, or to *persons closely associated* with them (for example, home mortgages, bank overdrafts or car loans), do not create an unacceptable threat to integrity or objectivity that compromises independence, provided that normal business terms apply. However, where such loans are in arrears by a significant amount, this creates an intimidation threat that compromises independence. Where such a situation arises, the *covered person* reports the matter to the *engagement partner* or to the *Ethics Partner*/Function, as appropriate and ceases to have any involvement with the *engagement*. The *engagement partner* or, where appropriate, the *Ethics Partner*/Function considers whether any *engagement* work is to be reperformed.

Business Relationships

2.27 A business relationship between:

(a) the *firm* or a *covered person*, or *persons closely associated* with them; and

(b) any *entity relevant to the engagement*, or the entity's *affiliates* or its management;

involves the two parties having a common commercial interest. Business relationships may create self-interest, advocacy or intimidation threats to integrity or objectivity and independence may be compromised. Examples include:

- joint ventures with the entity or with a director, officer or other individual who performs a management role for the entity;
- arrangements to combine one or more services or products of the *firm* with one or more services or products of the entity and to market the package with reference to both parties;
- distribution or marketing arrangements under which the *firm* acts as a distributor or marketer of any of the entity's products or services, or the entity acts as the distributor or marketer of any of the products or services of the *firm*;
- other commercial transactions, such as the *firm* leasing its office space from or to the entity.

Subject to the alternative procedures outlined in paragraph 1.40 of Section 1 of Part B of this Ethical standard that may be relevant to an *investment circular reporting engagement*, a *firm* will identify all business relationships entered into by the *firm*, *covered persons*, or *persons closely associated* with them.

2.28D **Persons or *firms* referred to in paragraph 2.4D shall not have a business or other relationship with any *entity relevant to an engagement* within the period referred in supporting ethical provision 2.1D that would compromise independence; or, if a person has such a business or other relationship they shall be excluded from any role by virtue of which they would be a *covered person* for such an *engagement*.** [AD 22.4]

2.29 ***Firms*, *covered persons* and *persons closely associated* with them shall not enter into business relationships with any *entity relevant to the engagement*, or its management or its *affiliates* except where those relationships:**

- **involve the purchase of goods or services from the *firm* or the entity in the ordinary course of business and on an arm's length basis and which are not material to either party; or**
- **would be inconsequential to either party in the view of an objective, reasonable and informed third party.**

For an *investment circular reporting engagement*, the requirement in paragraph 2.29 shall apply during the *relevant period* – the engagement period and any additional period before the engagement period but subsequent to the balance sheet date of the most recent audited financial statements of the entity.

2.30 Where there are doubts about whether a relationship would be inconsequential to either party in the view of and objective, reasonable and informed third party, then the relationship is not regarded as inconsequential.

2.31 Where a business relationship exists, that is not permitted under paragraph 2.29, and has been entered into by:

(a) *the firm:* either the relationship is terminated or the *firm* does not accept (or withdraws from) the *engagement*;

(b) *a covered person:* either the relationship is terminated or that person is excluded from any role in which they would be a *covered person*;

(c) a *person closely associated* with a *covered person:* either the relationship is terminated or the *covered person* is excluded from any role in which they would be a *covered person*.

In the case of an *investment circular reporting engagement*, where termination of the relationship is necessary it is undertaken before the start of the *relevant period*. If the existence of the transaction which is connected with the *investment circular* is price sensitive information then termination of the business relationship may not be possible and the *firm* either does not accept the *engagement* or the relevant individuals are not included in the *engagement team*. Where a partner with one of the business relationships specified normally has direct supervisory or management responsibility over the *engagement team*, he or she is excluded from this responsibility for the purposes of the particular *investment circular reporting engagement*.

For an *engagement* other than an *investment circular reporting engagement*, where there is an unavoidable delay in the termination of a business relationship, the *firm* adopts safeguards to preserve integrity and objectivity in relation to any relevant *engagements* until the relationship is terminated. These may include a review of the relevant person's *engagement* work or a

temporary exclusion of the relevant person from any role in which they would be a *covered person*.

2.32 Compliance with paragraph 2.29 is not intended to prevent a *firm* giving advice in accordance with regulatory requirements[30] to a third party in relation to investment products or services, including those supplied by an *entity relevant to an engagement*. In such circumstances, the *firm* considers the advocacy and self-interest threats that might be created by the provision of this advice where it gives rise to commission or similar payments by the entity to the *firm* and assesses whether any safeguards are required.

2.33 **Where a *covered person* becomes aware that a *close family* member has entered into one of the business relationships specified in paragraph 2.27, or any other business relationship that could impair independence, that person shall report the matter to the *engagement partner* to take appropriate action. If it is a *close family* member of the *engagement partner* or if the *engagement partner* is in doubt as to the action to be taken, the *engagement partner* shall resolve the matter through consultation with the *Ethics Partner*/Function.**

2.34 Where there are doubts as to whether a transaction or series of transactions are either in the ordinary course of business and on an arm's length basis or of such materiality that they constitute a threat to the integrity, objectivity or independence of the *firm* or *covered persons*, the *engagement partner* reports the issue:

- to the *Ethics Partner*/Function, so that a decision can be made as to the appropriate action that needs to be taken to ensure that the matter is resolved; and
- in the case of an *engagement* other than an *investment circular reporting engagement*, to those charged with governance of the entity, together with other significant facts and matters that bear upon the integrity, objectivity or independence of the *firm* and *covered persons*, to obtain their views on the matter.

2.35 **A *firm* shall not provide an *engagement* to any entity or person where that entity or person is in a position to influence the affairs of the *firm* or the performance of any *engagement* of the *firm*.**

2.36 This prohibition applies to:

(a) any entity that owns any significant part of the *firm*, or is an *affiliate* of such an entity; or

(b) any shareholder, director or other person in a position to direct the affairs of such an entity or its *affiliate*.

A significant ownership is one that carries the ability to influence materially the policy of an entity.[31]

---

[30] *Firms* providing such services will be authorised either by the Financial Conduct Authority or by their professional accountancy body acting as a Designated Professional Body.

[31] For companies, competition authorities have generally treated a 15% shareholding as sufficient to provide a material ability to influence policy.

Employment Relationships

2.37D **Persons or *firms* referred to in paragraph 2.4D shall not have an employment relationship with an *entity relevant to the engagement*, or an *affiliate* of such an entity, within the period referred in supporting ethical provision 2.1D that would compromise independence; or, if a person has such an employment relationship they shall be excluded from any role by virtue of which they would be a *covered person* for such an *engagement*.** [AD 22.4]

Management Role with an Entity Relevant to an Engagement

2.38 **A *firm* shall not admit to the partnership, or employ a person in a position as a *covered person*, if that person is also employed by any *entity relevant to the engagement*, or by any *affiliate* of such an entity ('dual employment').**

Loan Staff Assignments

2.39 **A *firm* shall not enter into an agreement with an *entity relevant to an engagement* other than an *investment circular reporting engagement*, or with the *affiliates* of such an entity, or otherwise, to provide any partner or employee ('loan staff') to work for a temporary period as if that individual were an employee of any such entity or its *affiliates* (a 'loan staff assignment') unless:**

(a) the agreement is for a short period of time and does not involve employees or partners performing *non-audit / additional services* that would not be permitted under this Ethical Standard; and

(b) the entity:

(i) agrees that any individual loan staff concerned will not hold a management position, will not be involved in the decision-taking of the entity and, in the case of an *audited entity* that is a *public interest entity*, will not play any part in the management of the entity; and

(ii) acknowledges its responsibility for directing and supervising the work to be performed, which will not include such matters as:

- **making management decisions; or**
- **exercising discretionary authority to commit the entity to a particular position or accounting treatment.**

2.40 **A *firm* shall not enter into an agreement with an *entity relevant to an investment circular reporting engagement* to provide any partner or employee ('loan staff') to work for a temporary period as if that individual were an employee of any such entity or its *affiliates* (a 'loan staff assignment') during the *relevant period* or for a period of one year before it unless:**

(a) the agreement is for a short period of time and does not involve employees or partners performing *additional services* that would not be permitted under this Ethical Standard; and

(b) the entity:

(i) agrees that any individual loan staff concerned will not hold a management position in relation to the transaction or the financial information that is the subject of the *investment circular reporting engagement*,; and

(ii) acknowledges its responsibility for directing and supervising the work to be performed, which will not include such matters as:

- **making management decisions; or**
- **exercising discretionary authority to commit the entity to a particular position or accounting treatment.**

2.41 Where a *firm* agrees to assist an *entity relevant to an engagement* by providing loan staff, threats to objectivity and independence may be created. A management threat may arise if the employee undertakes work that involves making judgments and taking decisions that are properly the responsibility of management. In the context of applying the requirement in paragraph 2.39(a) and 2.40(a), a short period of time is generally expected to be no more than a small number of months.

2.42 A self-review threat may also arise if the individual, during the loan staff assignment, is in a position to influence the preparation of the entity's financial statements or other *subject matter information* or *subject matter* of an *engagement*, and then, on completion of that assignment, is assigned to the *engagement team* for that entity, with responsibility to report on matters for which he or she was responsible whilst on that loan staff assignment.

2.43 **Where a partner or employee returns to the *firm* on completion of a loan staff assignment, that individual shall not be given any role on any *engagement* involving any function or activity that he or she performed or supervised during that assignment.**

2.44 In considering for how long this restriction is to be observed, the need to realise the potential value to the effectiveness of the *engagement* of the increased knowledge of the entity's business gained through the assignment has to be weighed against the potential threats to integrity or objectivity and the potential for independence to be compromised. Those threats increase with the length of the assignment and with the intended level of responsibility of the individual within the *engagement team*. As a minimum, this restriction will apply to at least the period until the first *engagement* has been completed following the completion of the loan staff assignment.

Partners and Engagement Team Members Joining an Entity Relevant to an Engagement

2.45 **Where a former partner in the *firm* joins an *entity relevant to an engagement*, the *firm* shall take action as quickly as possible - and, in any event, before any further work is done by the *firm* in connection with any such *engagement* - to ensure that no significant connections remain between the *firm* and the individual, or to withdraw from the *engagement*.**

2.46 Ensuring that no significant connections remain between the *firm* and the individual requires that:

- all capital balances and similar financial interests be fully settled (including retirement benefits) unless these are made in accordance with pre-determined arrangements that cannot be influenced by any remaining connections between the individual and the *firm*; and
- the individual does not participate or appear to participate in the *firm's* business or professional activities by way of employment, consultancy or other contractual arrangement, or in any other way.

2.47 ***Firms* shall establish policies and procedures that require in relation to any *entity relevant to an engagement* in which an individual is, or was at any time over the previous year (two years in the case of a partner), directly involved:**

(a) for all such *engagements:*

(i) senior members of the *engagement team* to notify the *firm* of any situation involving their potential employment with any such entity; and

(ii) other members of the *engagement team* to notify the *firm* of any situation involving their probable employment with any such entity;

(b) for an *engagement* other than an *investment circular reporting engagement*:

(i) all partners in the *firm* to notify the *firm* of any situation involving their potential employment with any such entity; and

(ii) any other employee of the *firm* and any other natural person whose services are placed at the disposal of or under the control of the *firm*, where such employee or other person is personally approved as a *statutory auditor* under relevant legislation within the European Union, to notify the *firm* of any situation involving their probable employment with any such entity;

(c) anyone who has given such notice to be removed from the *engagement team*; and

(d) a review of the *engagement* work performed by any resigning or former *engagement team* member in the current and, where appropriate, the most recent *engagement*.

2.48 Integrity, objectivity and independence may be threatened where a director, an officer or an employee of any *entity relevant to an engagement* who is in a position to exert direct and significant influence over the preparation of the financial statements or other *subject matter information* or *subject matter* of an *engagement*, has recently been a partner in the *firm*, a member of the *engagement team* or another employee or person whose services are at the disposal or under the control of the *firm*, where such employee or person is personally approved as a *statutory auditor* within the European Union. Such circumstances may create self-interest, familiarity and intimidation threats, particularly when significant connections remain between the individual and the *firm*. Similarly, integrity or objectivity may be threatened and

independence compromised when an individual knows, or has reason to believe, that he or she will or may be joining the entity at some time in the future.

2.49 Where a partner in the *firm* or a member of an *engagement team* for an *entity relevant to an engagement* or another person who is personally approved as a *statutory auditor* as described in paragraph 2.48 has left the *firm* and taken up employment with such an entity, the significance of the self-interest, familiarity and intimidation threats is assessed and normally depends on such factors as:

- the position that individual had in the *engagement team* or *firm*;
- the position that individual has taken at the entity;
- the amount of involvement that individual will have with the *engagement team* (especially where it includes former colleagues with whom he or she worked);
- the length of time since that individual was a member of the *engagement team* or employed by the *firm*.

Following the assessment of any such threats, appropriate safeguards are applied where necessary to reduce such threats to a level where the independence of the *firm* or *covered persons* would not be compromised.

2.50 Any review of *engagement* work is performed by a more senior *engagement* professional. If the individual joining the entity is a partner, the review is performed by a partner who is not involved in the *engagement*. Where, due to its size, the *firm* does not have a partner who was not involved in the *engagement*, it seeks either a review by another *firm* or advice from its professional body.

2.51 **As required by legislation[32], a natural person appointed as a *statutory auditor* or *key audit partner* for an entity subject to a *statutory audit* shall not take up:**

(a) any *key management position*;

(b) membership of the entity's audit committee;

(c) membership of any body performing equivalent functions to an audit committee in relation to the entity;

(d) any other position as director of the entity or, where the entity's affairs are managed by a management body or other committee, membership of that management body or committee;

before the end of:

(a) in the case of a *public interest entity*, two years; and

(b) in any other case, one year;

beginning with the day on which the person ceased to be the entity's *statutory auditor* or *key audit partner* in connection with the *statutory audit* of the entity.

[32] SI 2016/649 The Statutory Auditors and Third Country Auditors Regulations 2016, Schedule 1, paragraph 7.

2.52 The requirements set out in paragraph 2.51 above reflect legal restrictions imposed on particular individuals who may wish to join an entity subject to a *statutory audit*. Should a partner or other *covered person* join an *entity relevant to an engagement,* threats to integrity, objectivity and independence may arise that a *firm* will need to address. Such threats may also exist where a former partner or other *covered person* is employed by an entity that the *firm* is considering accepting an *engagement* for.

2.53 **Where a partner[33], or another person (including a person whose services are at the disposal or under the control of the *firm*) who is personally approved as a *statutory auditor* as described in paragraph 2.48, is appointed as a director (including as a non-executive director), a member of the audit committee or body performing equivalent functions, or to a *key management position* with an *entity relevant to an engagement*, having previously been a *covered person*:**

(a) in the case of a partner, at any time during the two years prior to such appointment; or

(b) in the case of another person, at any time during the year prior to such appointment;

the *firm* shall resign from the *engagement* where possible under applicable law or regulation.[34] The *firm* shall not accept an other *engagement* for the entity until:

(i) in the case of a partner, a two-year period; or

(ii) in the case of another person, a one year period;

commencing when the person ceased to be a *covered person*, has elapsed or until the person ceases employment with the entity, whichever is the sooner.

2.54 **In the circumstances covered by paragraph 2.53, where the responsibility for the *engagement* is assigned by legislation or regulation and the auditor cannot resign from the *engagement* (e.g. in the case of certain public sector bodies) the *firm* shall consider alternative safeguards that can be put in place to reduce threats to integrity or objectivity to a level where independence would not be compromised.**

2.55 **Where a person who is either a partner or another person (including a person whose services are at the disposal or under the control of the *firm*) who is personally approved as a *statutory auditor* as described in paragraph 2.48 (other than someone covered by paragraph 2.53) or was a former member of an *engagement team*, joins the entity as a director (including as a non-executive director), a member of the audit committee or body performing equivalent functions, or in a *key management position*, within two years of ceasing to be a *covered person* for the entity, the *firm* shall ensure that no significant connections remain**

---

[33] 'Partner' includes any individual with authority to bind the *firm* with respect to the performance of a professional services engagement.

[34] The timing of the *audit firm's* resignation as auditor is determined in accordance with paragraph 1.52 of Section 1 of Part B of this Ethical Standard.

between the *firm* and the individual and consider whether the composition of the *engagement team* is appropriate (paragraph 2.45 also applies in the case of a former partner).

2.56 The *firm* evaluates the appropriateness of the composition of the *engagement team* by reference to the factors listed in paragraph 2.49 and alters or strengthens the *engagement team* to address any threat to the integrity, objectivity or independence of the *firm* or *covered persons* that may be identified.

2.57 **If a former partner of the *firm*, or another person personally approved as a *statutory auditor* as described in paragraph 2.48 formerly employed by or otherwise at the disposal of or under the control of the *firm*, has joined an entity as a director (including as a non-executive director), a member of the audit committee or body performing equivalent functions, or in a *key management position*, the *firm* shall not accept an *engagement* for the entity where the person had, prior to leaving the *firm* and:**

(a) in the case of a partner, within two years before acceptance of the *engagement*; or

(b) in the case of another person, within one year before acceptance of the *engagement*;

been a *covered person* for any *engagement* involving any partner of the *firm* who would be a member of the *engagement team*, or would be the *engagement quality control reviewer*, for the *engagement* were it to be accepted.

2.58 **Where a former partner, or person (including a person whose services are at the disposal or under the control of the *firm*) personally approved as a *statutory auditor* as described in paragraph 2.48, left, or ceased to be at the disposal or under the control of, the *firm* earlier than the beginning of the periods specified in paragraph 2.57(a) or (b), the *firm* shall evaluate the significance of any threats to integrity or objectivity and whether independence would be compromised before accepting such an *engagement* for the entity. The *firm* shall not accept the *engagement* unless any threats identified can be reduced to a level where independence would not be compromised.**

Family Members Employed by an Entity Relevant to an Engagement

2.59 **Where a *covered person*, or any partner in the *firm*, becomes aware that a *person closely associated* with them, or a *close family* member who is not a *person closely associated* with them, is employed by an *entity relevant to the engagement* and that person is in a position to exercise influence on the accounting records or financial statements or other *subject matter information* or *subject matter* of such an *engagement*, that *covered person* or that partner shall either:**

(a) in the case of a *person closely associated* with them being employed by the entity in such a position, be excluded from any role in which they would be a *covered person*; or

(b) in the case of a *close family* member of a *covered person* who is not a *person closely associated with them*, or, <u>for an *engagement*</u>

other than an *investment circular reporting engagement*, any *close family* member of any partner in the *firm* who is not a *person closely associated* with them, report the matter to the *engagement partner* to take appropriate action. If it is a *close family* member of the *engagement partner* or if the *engagement partner* is in doubt as to the action to be taken, the *engagement partner* shall resolve the matter in consultation with the *Ethics Partner*/Function.

Governance Role with an Entity Relevant to an Engagement

2.60 Paragraphs 2.61 to 2.63 are supplementary to certain statutory or regulatory provisions that prohibit directors of entities from being appointed as their auditor.[35]

2.61 **The *firm* or a partner or member of *staff* of the *firm* shall not accept appointment or perform a role:**

(a) as an officer[36] or member of the board of directors of an *entity relevant to an engagement* of the *firm*;

(b) as a member of any subcommittee of that board; or

(c) in such a position in an entity which holds directly or indirectly more than 20% of the voting rights in the *entity relevant to an engagement*, or in an entity in which the *entity relevant to such an engagement* holds directly or indirectly more than 20% of the voting rights.

Where the *firm* is undertaking an *investment circular reporting engagement*, the requirements in this paragraph shall apply during the period of the *engagement*.

2.62 **Where a *covered person* becomes aware that a *person closely associated* with them, or a *close family* member who is not a *person closely associated* with them, holds a position described in paragraph 2.61, the *firm* shall take appropriate steps to ensure that the relevant person is excluded from any role in which they would be a *covered person*.**

2.63 **Where a partner or member of *staff* of the *firm*, but who is not a *covered person*, becomes aware that a *person closely associated* with them, or a *close family* member who is not a *person closely associated* with them, holds a position described in paragraph 2.61, that individual shall report that fact to the *engagement partner*, who shall evaluate whether the relationship would compromise independence. If the *engagement partner* concludes that independence may be compromised, they shall**

[35] For example, in the case of limited companies and certain other organisations, section 1214 of the Companies Act 2006 contains detailed provisions. Amongst other things, these state that:

'…A person may not act as *statutory auditor* of an audited person if [he] is (a) an officer or employee of the audited person, or (b) a partner or employee of such a person, or a partnership of which such a person is a partner.'

[36] As defined in Section 1173 of the Companies Act 2006 as including a director, manager or secretary.

consult with the *Ethics Partner*/Function to determine whether appropriate safeguards exist. If no such safeguards exist, the *firm* shall withdraw from the *engagement*.

Employment with the Firm

2.64 Integrity and objectivity may be threatened and independence may be compromised where a former director or employee of an *entity relevant to an engagement* of the *firm* becomes a member of the *engagement team* or is otherwise a *covered person*. Self-interest, self-review and familiarity threats may be created where a member of the *engagement team* has to report on, for example, financial statements which he or she prepared, or other information for which he or she had responsibility, while with the entity.

2.65 **Where a former director or a former employee of an *entity relevant to an engagement*, who was in a position to exert significant influence over the preparation of the financial statements or other *subject matter information* or *subject matter* of such an *engagement*, joins the *firm*, that individual shall be excluded from any role in which they would be a *covered person* relevant to that entity or its *affiliates* for a period of two years following the date of leaving the entity.**

2.66 Recusal from responsibilities of any particular role with respect to influencing particular matters cannot remove the individual from being in a position to do so. In certain circumstances, a longer period of exclusion from being a *covered person* may be appropriate. For example, threats to integrity, objectivity and independence may exist in relation to an *engagement* for any period where the financial statements or other *subject matter information* or other *subject matter* of such an *engagement*, are materially affected by the work of that person whilst occupying his or her former position of influence with the entity. The significance of these threats depends on factors such as:

- the position the individual held with the entity;
- the length of time since the individual left the entity;
- the position the individual holds in the *engagement team* or the *firm*.

Family and Other Personal Relationships

2.67 A relationship between a *covered person* and a party other than those referred to elsewhere in this Section does not generally affect the consideration of integrity and objectivity and the evaluation of whether independence is compromised. However, if it is a relationship with a family member, and if the family member also has a financial, business or employment relationship with any *entity relevant to the engagement*, then this may create self-interest, familiarity or intimidation threats to integrity and objectivity and may impair independence. The significance of any such threats depends on such factors as:

- the relevant person's involvement in the *engagement*;
- the nature of the relationship between the relevant person and his or her family member;
- the family member's relationship with the entity.

2.68 A distinction is made between relationships with "*persons closely associated*" (which include *immediate family* members – a spouse or equivalent and dependents), and other *close family* relationships (which additionally comprise any other parents, non-dependent children and siblings who are not '*persons closely associated*'). While an individual can usually be presumed to be aware of matters concerning *persons closely associated* with them and to be able to influence their behaviour, it is generally recognised that the same levels of knowledge and influence do not exist in the case of *close family* members who are not a *person closely associated* with them.

2.69 When considering family relationships, it needs to be acknowledged that the concept of what constitutes a family is evolving and relationships between individuals which have no status formally recognised by law may nevertheless be considered as significant as those which do. It may therefore be appropriate to regard certain other personal relationships, particularly those that would be considered close personal relationships, as if they are family relationships.

2.70 **The *firm* shall establish policies and procedures that require:**

(a) partners and professional *staff* members to report to the *firm* any *persons closely associated* with them, any *close family* who are not a *person closely associated with them,* and other personal relationships, where any of those persons is involved with an *entity relevant to an engagement* of the *firm*, where the partner or professional *staff* member considers that the relationship might create a threat to integrity or objectivity or may compromise independence;

(b) the relevant *engagement partners* to be notified promptly of any information reported by partners and other professional *staff* members as required by paragraph (a).

2.71 **The *engagement partner* shall:**

(a) assess the threats to integrity and objectivity and evaluate whether independence would be compromised, on the basis of the information reported to the *firm* by partners and other professional *staff* members as required by paragraph 2.70;

(b) apply appropriate safeguards to eliminate any threats or to reduce them to a level where independence would not be compromised; and

(c) where there are unresolved matters or the need for clarification, consult with the *Ethics Partner*/Function.

2.72 Where such matters are identified or reported, the *engagement partner* or the *Ethics Partner*/Function assesses the information available and the potential for there to be a threat to integrity or objectivity and for independence to be compromised, treating any personal relationship as if it were a family relationship.

External Consultants Involved in an Engagement

2.73 *Firms* may employ external consultants as experts as part of their *engagement*, for example, in an *audit engagement*, in order to obtain sufficient

appropriate audit evidence regarding certain financial statement assertions.[37] There may be threats to an expert's integrity or objectivity and their independence may be compromised if the expert is related to any *entity relevant to the engagement*, for example by being financially dependent upon or having an investment in, the entity.

2.74 **The *engagement partner* shall be satisfied that any external consultant involved in the *engagement* will act with integrity and objectivity with respect to the *engagement* and shall document the rationale for that conclusion.**

2.75 The *engagement partner* obtains information from the external consultant as to the existence of any connections that they have with the entity including:

- financial interests;
- business relationships;
- employment (past, present and future);
- family and other personal relationships.

[37] ISA (UK) 620 (Revised June 2016) *'Using the Work of an Auditor's Expert'* requires that the auditor shall evaluate whether the expert has the necessary objectivity.

Section 3 – Long Association with Engagements and With Entities Relevant to Engagements

General Requirements

3.1 **The *firm* shall establish policies and procedures to monitor the length of time and extent of involvement that partners and *staff* in senior positions, including those from other disciplines, serve as members of the *engagement team(s)* for recurring *engagements* for particular entities.**

3.2 **Where partners and *staff* in senior positions have a long association or extensive involvement with an *entity relevant to the engagement*, the *firm* shall assess the threats to integrity, objectivity and independence of the *firm* and *covered persons* and shall:**

- **apply safeguards to reduce the threats to a level where independence would not be compromised; and**
- **disclose the *engagements* previously undertaken by the *firm* for an *entity relevant to the engagement* to those charged with governance and, where applicable, any other persons or entities the *firm* is instructed to advise.**

Where appropriate safeguards cannot be applied, the *firm* shall not accept the *engagement*, shall resign from the *engagement* or not stand for reappointment, as appropriate. Where the responsibility for the *engagement* is assigned by legislation or regulation and the *firm* cannot resign from the *engagement* (e.g. in the case of certain public sector bodies) the *firm* shall consider alternative safeguards that can be put in place.

3.3 Where partners and *staff* in senior positions have a long association or extensive involvement with an *entity relevant to the engagement*, self-interest, self-review and familiarity threats to the integrity or objectivity of any person performing the *engagement* may arise. Similarly, such circumstances may impair, and could compromise, independence. The significance of such threats depends upon factors such as:

- the role of the individual in the *engagement team(s)*;
- the proportion of time that the entity contributes to the individual's annual billable hours;
- the length of time that the individual has been associated with an *entity relevant to the engagement*;
- whether the individual is employed exclusively or principally on an *engagement* that extends for a significant period of time;
- whether the individual is remunerated on the basis of the performance of a part of the *firm* which is substantially dependent on fees from that entity.

3.4 For an *investment circular reporting engagement*, the *firm* gives careful consideration to which individual is appointed as the *engagement partner* on

such an *engagement*. This consideration will reflect the need for relevant expertise[38] as well as factors such as:

- the nature of the *investment circular reporting engagement* and whether it will involve the reappraisal of previously audited financial information;
- the length of time that the *engagement partner* for the *audit engagement* has been associated with the *audit engagement*;
- the length of time that other partners have acted for the entity on corporate finance and other transaction related engagements;
- whether the objectivity of the *engagement partner* on a subsequent *engagement* could be adversely affected by an opinion on a profit forecast included in the investment circular; and
- the scope of the engagement quality control review.

3.5 In order to address threats that are identified, *firms* apply safeguards. Appropriate safeguards may include:

- appointing a partner who has no previous involvement with the entity as the *engagement partner*;
- removing ('rotating') the partners and the other senior members of the *engagement team* after a pre-determined number of years;
- involving an additional partner, who is not and has not recently been a member of the *engagement team*, to review the work done by the partners and the other senior members of the *engagement team* and to advise as necessary;
- arranging an engagement quality control review of the *engagement* in question.

3.6 Where applicable, once an *engagement partner* has held this role for a continuous period of ten years, careful consideration is given as to whether it is probable that an objective, reasonable and informed third party would conclude the integrity, objectivity or independence of the *firm* or *covered persons* are compromised. Where the individual concerned is not rotated after ten years, it is important that:

(a) safeguards other than rotation, such as those noted in paragraph 3.5, are applied; or

(b) (i) the reasoning as to why the individual continues to participate in the *engagement* without any safeguards is documented; and

(ii) the facts are communicated to those charged with governance of the entity in accordance with paragraphs 1.61 – 1.71 of Section 1 of Part B of this Ethical Standard.

3.7 The *firm's* policies and procedures set out whether there are circumstances in which the *engagement partners*, *engagement quality control reviewers* and other key partners involved in recurring *engagements* for non-listed entities that are not *public interest entities* are subject to accelerated rotation

[38] Paragraph 25 of SIR 1000 requires that a partner with appropriate experience should be involved in the conduct of the work.

requirements, such as those set out in paragraph 3.11, as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

3.8 Any scheme of rotation of partners and other senior members of the *engagement team* needs to take into account the factors which affect the quality of the *engagement* work, including the experience and continuity of members of the *engagement team* and the need to ensure appropriate succession planning.

Public Interest Entities and Other Listed Entities

The requirements and guidance in paragraphs 3.9 – 3.23 are relevant to recurring *engagements* that are undertaken for an entity over periods of five or more years.

Audit Firm Rotation

3.9 **The requirements for *audit firm* rotation, implementing the relevant provisions of Article 17 of the EU Audit Regulation, are set out in legislation[39]. The *firm* shall ensure that it does not accept or continue an *audit engagement* that would cause those requirements to not be complied with.**

Key Audit Partners and Engagement Partners[40]

3.10R **Save where the circumstances in paragraphs 3.14 and 3.15 apply, the *key audit partners* responsible for carrying out a *statutory audit* of a *public interest entity* shall cease their participation in the *statutory audit* of the *audited entity* not later than ~~seven~~ five[41] years from the date of their appointment. They shall not participate again in the *statutory audit* of the *audited entity* before ~~three~~ five years have elapsed following that cessation.** [AR 17.7]

3.11 **In the case of *listed entities*, save where the circumstances contemplated in paragraph 3.14 and 3.15 apply, the *firm* shall establish policies and procedures to ensure in respect of a recurring *engagement* that:**

(a) no one shall act as *engagement partner* for more than five years; and

(b) anyone who has acted as the *engagement partner* for a particular entity for a period of five years, shall not subsequently participate in the *engagement* until a further period of five years has elapsed.

3.12 The roles that constitute participating in an *engagement* for the purposes of paragraph 3.11(b), include providing quality control for the *engagement*, advising or consulting with the *engagement team* or the entity regarding technical or industry specific issues, transactions or events, or otherwise directly influencing the conduct or outcome of the *engagement*. This does not

---

[39] Sections 487 and 489 of the Companies Act 2006.

[40] For an audit, the *engagement partner* is a *key audit partner*.

[41] The FRC has exercised the Member State option in the second sub-paragraph of Article 17.7 to set a shorter period than the default seven year period.

include responding to queries in relation to any completed *engagement*. This is not intended to preclude partners whose primary responsibility within a *firm* is to be consulted on technical or industry specific issues from providing such consultation to the *engagement team* or entity after a period of two years has elapsed from their ceasing to act as *engagement partner*, provided that such consultation is in respect of new issues or new types of transactions or events that were not previously required to be considered by that individual in the course of acting as *engagement partner*.

3.13 Where an *engagement partner* continues in a non-engagement role having been rotated off the *engagement team*, the new *engagement partner* and the individual concerned ensure that that person, while acting in this new role, does not exert any influence on the *engagement*. Positions in which an individual is responsible for the *firm's* client relationship with the particular entity would not be an acceptable non-engagement role.

3.14 When an entity becomes a *public interest entity* or an other *listed entity*, the length of time the *engagement partner* has served the entity in that capacity is taken into account in calculating the period before the *engagement partner* is rotated off the *engagement team*. However, where the *engagement partner* has already served for four or more years, that individual may continue to serve as the *engagement partner* for not more than two years after the entity becomes such a *public interest entity* or an other *listed entity*.

3.15 In circumstances where the audit committee (or equivalent) of an entity that is a *public interest entity* or an other *listed entity* decide that a degree of flexibility over the timing of rotation is necessary to safeguard the quality of the *engagement* and the *firm* agrees, the *engagement partner* may continue in this position for an additional period of up to two years, so that no longer than seven years in total is spent in the position of *engagement partner*. An audit committee and the *firm* may consider that such flexibility safeguards the quality of the *engagement*, for example, where:

- substantial change has recently been made or will soon be made to the nature or structure of the entity's business; or
- there are unexpected changes in the senior management of the entity; or
- the *firm*, having taken all reasonable succession planning steps, has no other partners with the necessary knowledge and experience who are able to take over as *engagement partner*.

In these circumstances alternative safeguards are applied to reduce any threats to a level where it is not probable that an objective, reasonable and informed third party would conclude the integrity, objectivity or independence of the *firm* or *covered persons* are compromised. Such safeguards may include ensuring that an expanded review of the *engagement* work is undertaken by the *engagement quality control reviewer* or a partner with relevant expertise, who is not involved in the *engagement*.

3.16 For an *audit engagement*, where it has been determined that the *engagement partner* may act for a further period (not to exceed two years) in the interests of audit quality, this fact and the reasons for it, are to be disclosed to the *audited entity's* shareholders as early as practicable and in each of the additional years. If the *audited entity* is not prepared to make such a

disclosure, the *audit firm* does not permit the *engagement partner* to continue in this role.

3.17 In the case of joint audit arrangements for *public interest entities* and for other *listed entities*, *audit firms* will make arrangements for changes of *engagement partners* over a five-year period so that the familiarity threat is avoided, whilst also taking into consideration factors that affect the quality of the audit work.

Engagement Quality Control Reviewers and Other Key Partners Involved in the Engagement

3.18R **For an audit of a *public interest entity*, the ~~statutory auditor or the~~ *audit firm* shall establish an appropriate gradual rotation mechanism with regard to the most senior personnel involved in the *statutory audit*, including at least the persons who are registered as *statutory auditors*. The gradual rotation mechanism shall be applied in phases on the basis of individuals rather than of the entire *engagement team*. It shall be proportionate in view of the scale and the complexity of the activity of the ~~statutory auditor or the~~ *audit firm*.** [AR 17.7]

3.19R **For an audit of a *public interest entity*, the ~~statutory auditor or the~~ *audit firm* shall be able to demonstrate to the competent authority[42] that such mechanism is effectively applied and adapted to the scale and the complexity of the activity of the ~~statutory auditor or the~~ *audit firm*.** [AR 17.7]

3.20 **In the case of *public interest entities* and other *listed entities*, the *firm* shall establish policies and procedures to ensure in respect of a recurring *engagement* that:**

(a) no one shall act as the *engagement quality control reviewer* or a *key partner involved in the engagement* for a period longer than seven years;

(b) where an *engagement quality control reviewer* or a *key partner involved in the engagement* becomes the *engagement partner*, the combined period of service in these positions shall not exceed seven years; and

(c) anyone who has acted:

(i) **as an *engagement quality control reviewer* for a particular entity for a period of seven years, whether continuously or in aggregate, shall not participate in the *engagement* until a further period of five years has elapsed;**

(ii) **as a *key partner involved in the engagement* for a particular entity for a period of seven years, whether continuously or in aggregate, shall not participate in the *engagement* until a further period of two years has elapsed;**

(iii) **in a combination of roles as:**

- **the *engagement quality control reviewer*,**

[42] The FRC or the Recognised Supervisory Body to whom the FRC has delegated regulatory tasks, as applicable.

- **a *key partner involved in the engagement*, or**
- **the *engagement partner***

for a particular entity for a period of seven years, whether continuously or in aggregate, shall not participate in the *engagement* until a further period of five years has elapsed.

Other Partners and Staff Involved in the Engagement in Senior Positions

3.21 **In the case of *public interest entities* and other *listed entities*, the *engagement partner* shall review the safeguards put in place to address the threats to the objectivity and independence of the person or persons conducting the *engagement* arising where partners and *staff* have been involved in the *engagement* in senior positions for a continuous period longer than seven years and shall discuss those situations with the *engagement quality control reviewer*. Any unresolved problems or issues shall be referred to the Ethics Function / Partner.**

3.22 The significance of the threats arising where partners and *staff* have been involved in the *engagement* in senior positions for a continuous period longer than seven years will depend on:

- the total period of time that the individual has been involved in the *engagement*;
- changes in the nature of the work and the role performed by the individual during that period; and

the portion of time the individual has spent on any engagements with the entity during that period.

3.23 Following the assessment of any such threats, appropriate safeguards are applied where necessary. Safeguards that address these threats might include:

- changes in the roles within the *engagement team*;
- an additional review of the work done by the individual by the *engagement partner* or other partners in the *engagement team*;
- additional procedures carried out as part of the engagement quality control review.

If such safeguards do not reduce the threats to a level where independence is not compromised, the partner or member of *staff* is removed from the *engagement team*.

Section 4 – Fees, Remuneration and Evaluation Policies, Gifts and Hospitality, Litigation

Fees

4.1 **The *engagement partner* shall be satisfied and able to demonstrate that the *engagement* has assigned to it sufficient partners and *staff* with appropriate time and skill to perform the *engagement* in accordance with all applicable Engagement and Ethical Standards, irrespective of the *engagement* fee to be charged.**

4.2 Paragraph 4.1 is not intended to prescribe the approach to be taken by *firms* to the setting of *engagement* fees, but rather to emphasise that there are no circumstances where the amount of the *engagement* fee can justify any lack of appropriate resource or time taken to perform a proper *engagement* in accordance with applicable Engagement and Ethical Standards.

4.3D **Fees for *engagements* shall not be influenced or determined by the provision of *non-audit / additional services* to an *entity relevant to the engagement*.** [AD 25, ES 4.7]

4.4 The *engagement* fee ordinarily reflects the time spent, the skills and experience of the personnel performing the *engagement* in accordance with all the relevant requirements, and the competitive situation in the market. Paragraph 4.3D is intended to prevent any relationship between the appropriate cost of the *engagement* and the actual or potential provision of *non-audit / additional services*.

4.5 Paragraph 4.3D is not intended to prohibit proper cost savings that can be achieved as a result of providing *non-audit / additional services* in accordance with Section 5 of this Ethical Standard to the entity, for example, where information gained through undertaking a *non-audit service* is referred to by audit staff when carrying out the audit of the financial statements.

4.6R **Fees for the provision of ~~statutory audits~~ *engagements* ~~to public interest entities~~ shall not be contingent fees.** [AR 4.1]

4.7R ~~Without prejudice to Article 25 of Directive 2006/43/EC, for the purposes of the first subparagraph, c~~Contingent fees means fees ~~for audit engagements~~ calculated on a predetermined basis relating to the outcome or result of a transaction, or other event, or the result of the work performed. Fees shall not be regarded as being contingent if a court, ~~or a~~ competent authority, or other public authority has established them. [AR 4.1]

4.8 A *contingent fee basis* includes any arrangement made at the outset of an *engagement* under which a specified commission on or percentage of any consideration or saving is payable to the *firm* upon the happening of a specified event or the achievement of an outcome (or alternative outcomes). Differential hourly fee rates, or arrangements under which the fee payable will be negotiated after the completion of the *engagement*, or increased to cover additional work identified as necessary during the *engagement*, do not constitute contingent fee arrangements.

4.9 Contingent fee arrangements in respect of *engagements* create self-interest threats to the integrity and objectivity of the *firm* and *covered persons* that are so significant that they cannot be eliminated or reduced to a level where independence would not be compromised.

4.10 The fee for an *engagement* does not depend on whether the *firm's* report on the financial statements, or on *subject matter information* or other *subject matter* of such an *engagement*, is qualified or unqualified. The basis for the calculation of the fee is agreed with the entity before significant *engagement* work is undertaken and ordinarily reflects the time spent and the skills and experience of the personnel performing the *engagement* in accordance with all the relevant requirements. For recurring *engagements*, such as an audit, the fee is agreed before each recurrence. Arrangements under which estimated fees are agreed with the entity on terms where the fees may be varied based on the level of *engagement* work required do not constitute contingent fee arrangements.

4.11 Investigations into possible acquisitions or disposals ('due diligence engagements'), particularly those performed in relation to a prospective transaction, typically involve a high level of risk and responsibility. A *firm* carrying out a due diligence engagement may charge a higher fee for work relating to a completed transaction than for the same transaction if it is not completed, for whatever reason, provided that the difference is related to such additional risk and responsibility and not the outcome of the due diligence engagement.

4.12 In relation to *investment circular reporting engagements*, where the *firm* is aware that an *entity relevant to the engagement* has a record of seeking substantial discounts to the fee payable where a transaction is unsuccessful or abortive, the *engagement partner* discusses the position with the *Ethics Partner*. An appropriate safeguard may involve arranging an engagement quality control review of the *investment circular reporting engagement*.

4.13 Contingent fee arrangements in respect of *non-audit / additional services* provided by the *firm* in respect of an entity can create significant self-interest threats to the integrity, objectivity and independence of the *firm* and *covered persons*, as they may have, or may appear to have, an interest in the outcome of the *non-audit / additional service*.

4.14 **The *firm* shall not provide *non-audit / additional services*, in respect of an *entity relevant to an engagement*, wholly or partly on a *contingent fee basis* where:**

(a) the contingent fee is material to the *firm*, or that part of the *firm* by reference to which the *engagement partner's* profit share is calculated; or

(b) the amount of the fee is dependent on an outcome or result of those *non-audit / additional services* that is relevant to a future or contemporary judgment relating to a material matter in the financial statements or other *subject matter information* or *subject matter* of the *engagement*.

In relation to tax services, the requirements of paragraph 5.85 of Section 5 of Part B of this Ethical Standard also apply.

4.15 Where *non-audit / additional services* are provided on a *contingent fee basis*, there may be a perception that the *firm's* interests are so closely aligned with the entity that the integrity, objectivity and independence of the *firm* and *covered persons* could be, or be seen to be, compromised.

4.16 The significance of the self-interest threat is likely to be, or be seen to be, influenced by the materiality of the contingent fee to the *firm* or to the part of the *firm* by reference to which the *engagement partner's* profit share is calculated - any contingent fee that is material to the *firm*, or that part of the *firm* by reference to which the *engagement partner's* profit share is calculated, will create a self-interest threat that cannot be eliminated or reduced to a level where independence is not compromised and the *firm* does not undertake such a service at the same time as an *audit engagement* or other *public interest assurance engagement*.

4.17 In addition, where the contingent fee is dependent on an outcome or result of the *non-audit / additional service* that is relevant to a future or contemporary audit or assurance judgment relating to a material matter that is included in the audited financial statements, in the case of an *entity relevant to an engagement*, the self-interest threat cannot be eliminated or reduced to a level where independence is not compromised.

4.18 Paragraph 4.14 is not intended to prohibit a *firm* from charging a lower fee where the service relates to a transaction or engagement that was either aborted or prematurely terminated for whatever reason and where the rationale for the lower fee is to take account of either the reduced risk and responsibility involved or the fact that less work was undertaken than had been anticipated.

4.19 For *non-audit / additional services* provided on a *contingent fee basis*, other than those prohibited under paragraph 4.14, the *engagement partner* assesses the significance of the self-interest threat and considers whether there are safeguards that could be applied which would be effective to eliminate the threat or reduce it to a level where independence is not compromised. The significance of the self-interest threat will depend on factors such as:

- the range of possible fee amounts;
- the nature of the *non-audit / additional service*;
- for an audit, the effect of the outcome of the additional *non-audit service* on the financial statements of the *audited entity*;
- for an other *public interest assurance engagement*, the effect of the outcome of the additional service on the *subject matter information* or *subject matter* of the *engagement*.

4.20 Examples of safeguards that might be applied to reduce any self-interest threats arising from the provision of *non-audit / additional services* on a *contingent fee basis* (other than those set out in paragraph 4.14 above) to a level where independence is not compromised include:

- the provision of such *non-audit / additional services* by partners and *staff* who have no involvement in the *engagement*;

- review of the *engagement* by a partner with relevant expertise who is not involved in the *engagement* to ensure that the *subject matter* of the *non-audit / additional service* has been properly and effectively addressed in the context of the *engagement*.

4.21 For an *investment circular reporting engagement*, in situations where a *reporting accountant* can see at the outset of the *investment circular reporting engagement* that there is likely to be a judgment that will be made in relation to a material aspect of the *investment circular reporting engagement* which could adversely affect the successful completion of the transaction to which the investment circular relates, the *firm* will not agree to undertake any corporate finance services in relation to the transaction on a *contingent fee basis*, or will not accept the *investment circular reporting engagement*. Where corporate finance services are entered into on a *contingent fee basis* and a judgment needs to be made in relation to a material aspect of the *investment circular reporting engagement* during the course of an *investment circular reporting engagement*, then the *firm* changes the terms of the corporate finance service so that it no longer involves a contingent fee or withdraws from either the relevant corporate finance service or the *investment circular reporting engagement*.

4.22 Where the *firm* provides a range of corporate finance services to an *entity relevant to the engagement*, including acting as a Sponsor or Nominated Advisor, on terms that involve a contingent fee, and that *firm* also undertakes a public reporting engagement for an *entity relevant to the engagement*, the self-interest threat caused by contingent fee arrangements may be reduced to a level where independence is not compromised by the application of safeguards, such as the corporate finance services being provided by partners and *staff* who have no involvement in the *investment circular reporting engagement*. In such circumstances the *reporting accountant* ensures that the situation is fully disclosed to the Financial Conduct Authority (FCA) or the London Stock Exchange and any related regulatory requirements have been complied with.

4.23 **The *firm* shall establish policies and procedures to ensure that the *engagement partner* and the *Ethics Partner*/Function are notified where others within the *firm* propose to adopt contingent fee arrangements in relation to the provision of *non-audit / additional services* to the *entity relevant to the engagement* or its *affiliates*.**

4.24 Contingent fee arrangements in respect of *non-audit / additional services* provided by the *firm* may create a threat to the integrity, objectivity or independence of the *firm* and *covered persons*. The circumstances in which such fee arrangements are not permitted for *non-audit / additional services* are dealt with in paragraph 4.14 of this Section.

4.25 **In the case of *public interest entities* and of other *listed entities relevant to an engagement*, the *engagement partner* shall disclose to the audit committee, in writing, any contingent fee arrangements for *non-audit / additional services* provided by the *firm* or its *network firms*.**

4.26 In the case of a group *engagement* of a *public interest entity* or of an other *listed entity*, which involves other *firms*, the letter of instruction sent by the group *engagement partner* to the other *firms* requests disclosure of any

contingent fees for *non-audit / additional services* charged or proposed to be charged by the other *firms*.

4.27 **For a recurring *engagement*, the actual amount of the *engagement* fee for the previous *engagement* and the arrangements for its payment shall be agreed with the entity before the *firm* formally accepts appointment for the *engagement* in respect of the following period.**

4.28 Ordinarily, any outstanding fees for the previous engagement period are paid before the *firm* commences any new *engagement* work. Where they are not, it is important for the *engagement partner* to understand the nature of any disagreement or other issue.

4.29 **Where fees for professional services from an entity are overdue and the amount cannot be regarded as trivial, the *engagement partner*, in consultation with the *Ethics Partner*/Function, shall consider whether the *firm* can accept or continue an *engagement* for the entity or whether it is necessary to resign.**

4.30 Where fees due from an entity, whether for *an audit engagement*, *other public interest assurance engagements*, or for other professional services, remain unpaid for a long time - and, in particular, where a significant part is not paid before the *firm's* audit report on the financial statements for the following year, or report on other *subject matter information* or *subject matter* in the case of an other *public interest assurance engagemen*t for a subsequent *engagement,* is due to be issued - a self-interest threat to the integrity, objectivity and independence of the *firm* and *covered persons* is created because the issue of an unqualified report may enhance the *firm's* prospects of securing payment of such overdue fees.

4.31 Where the outstanding fees are in dispute and the amount involved is significant, the threats to the integrity and objectivity of the *firm* and *covered persons* may be such that they cannot be reduced to a level where independence would not be compromised. The *engagement partner* therefore considers whether the *firm* can continue with the *engagement*.

4.32 Where the outstanding fees are unpaid because of exceptional circumstances (including financial distress), the *engagement partner* considers whether the entity will be able to resolve its difficulties. In deciding what action to take, the *engagement partner* weighs the threats to the integrity, objectivity and independence of the *firm* and *covered persons*, if the *firm* were to remain appointed to provide the *engagement*, against the difficulties the entity would be likely to face in finding a successor, and therefore the public interest considerations, if the *firm* were to resign or withdraw from the *engagement*.

4.33 In any case where the *firm* does not resign from the *engagement*, the *engagement partner* applies appropriate safeguards (such as a review by a partner with relevant expertise who is not involved in the *engagement*) and notifies the *Ethics Partner* of the facts concerning the overdue fees.

4.34R **When the ~~statutory auditor or the~~ *audit firm*, or a member of its network, provides to ~~the audited~~ *a public interest entity* that it audits, its parent undertaking or its controlled undertakings, ~~for a period of three or more~~**

~~consecutive financial years,~~ **non-audit services other than those referred to in Article 5(1)[43] of ~~this~~ the EU Audit Regulation:**

(a) the total fees for such services provided to the audited entity and its controlled undertakings shall be limited to no more than 70% of the average of the fees paid in the last three consecutive financial years[44] for the ~~statutory~~ audit(s) of the audited entity and ~~of its parent undertaking,~~ of its controlled undertakings and of the consolidated financial statements of that group of undertakings; and

(b) the total fees for such services provided by the *audit firm* shall be limited to no more than 70% of the average of the fees paid to the *audit firm* in the last three consecutive financial years[45] for the ~~statutory~~ audit(s) of the audited entity and, where applicable, of its parent undertaking, of its controlled undertakings and of the consolidated financial statements of that group of undertakings. [AR 4.2]

4.35R **For the purposes of the limits specified in ~~the first subparagraph~~ paragraph 4.34R, non-audit services, other than those referred to in Article 5(1) of the EU Audit Regulation, required by Union or national legislation shall be excluded.** [AR 4.2]

4.36R **Upon a request by the ~~statutory auditor or the~~ *audit firm*, on an exceptional basis, the competent authority[45] may allow that ~~statutory auditor or~~ *audit firm* to be exempt from the requirements in ~~the first sub-paragraph~~ paragraph 4.34R in respect of an *audited entity* for a period not exceeding two financial years.** [AR 4.2]

4.37 **In the case of *public interest entities* and of other *listed entities,* where:**

(a) the fees charged by the *firm* and members of its *network* in aggregate: or

(b the fees charged by the *firm* or by any member of its *network* whose work is used in the conduct of the *engagement;*

for *non-audit / additional services*, and for services provided to *connected parties* that may bear on independence, for a financial year are expected to be greater than the aggregate (or the individual firm's) annual fees for the *engagement*, the *engagement partner* shall provide details of the circumstances to the *Ethics Partner*/Function and discuss them with him or her. The *engagement partner* shall determine whether the threats to independence of the *firm* or any such member of its network are at a level where independence is not compromised or, if necessary, put in place appropriate safeguards such that independence is not compromised, which may include the *firm* or member of its network not providing the *non-audit / additiona*l service.

---

[43] See paragraph 5.167R of Section 5 of Part B of this Ethical Standard.

[44] This requirement does not apply retrospectively. The cap is based on average audit fees for the three consecutive financial periods commencing on or after 17 June 2016. Following the appointment of a new auditor after that date the cap will apply from the fourth financial period of that engagement.

[45] The competent authority for this purpose is the Financial Reporting Council.

4.38 **Where the *firm* and/or members of its network provide services to a group, the requirement in paragraph 4.37 shall apply on a group basis for all services provided by the *firm* and its *network firms* to all entities in the group and to their *connected parties*.**

4.39 Where substantial fees are regularly generated from the provision of *non-audit / additional services* and the fees for *non-audit / additional services* are greater than the annual fees for recurring *engagements* for an entity, the *engagement partner* has regard to the possibility that there may be perceived to be a loss of independence resulting from the expected or actual level of fees for *non-audit / additional services*. The *engagement partner* determines whether there is any risk that there will be an actual loss of integrity, objectivity or independence by the *firm* or *covered persons*. In making that assessment, the *engagement partner* considers matters such as whether the *non-audit / additional services* were:

- audit related services;
- provided on a *contingent fee basis*;
- consistent with the services undertaken and fees received on a consistent basis in previous years;
- in the case of a group, disproportionate in relation to any individual group entity;
- unusual in size but unlikely to recur; and/or
- of such a size and nature that an objective, reasonable and informed third party would be concerned at the effect that such services would have on the integrity, objectivity and independence of the *firm* or *covered persons*.

Having made that assessment, the *engagement partner* determines whether the threats to independence from the level of fees for *non-audit / additional services* are at a level where independence is not compromised (or can be reduced to such a level by putting in place appropriate safeguards) and appropriately informs the audit committee or those charged with governance of the position on a timely basis in accordance with paragraphs 1.61, 1.66 and 1.67 of Section 1 of Part B of this Ethical Standard.

4.40 Discussing the level of fees for *non-audit / additional services* with the *Ethics Partner*/Function ensures that appropriate attention is paid to the issue by the *firm*. The *firm's* policies and procedures will set out whether there are circumstances in which the *engagement partner* responsible for the *engagement* discusses the level of *non-audit / additional service* fees with the *Ethics Partner*/Function for non-listed entities, that are not *public interest entities*, as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

4.41 Paragraphs 4.42 to 4.52 below do not apply to *engagements* of entities where the responsibility for the *engagement* is assigned by legislation and the *firm* cannot resign from the *engagement*, irrespective of considerations of economic dependence (e.g. for certain public sector bodies).

4.42 **Where it is expected that the total fees for services receivable from a *public interest entity* or other *listed entity* and its subsidiaries relevant**

to a recurring *engagement* by the *firm*[46] will regularly exceed 10% of the annual fee income of the *firm*[47] or, where profits are not shared on a *firm*-wide basis, of the part of the *firm* by reference to which the *engagement partner's* profit share is calculated, the *firm* shall not act as the provider of the *engagement* for that entity and shall either resign or not stand for reappointment, as appropriate.

4.43 The requirements in paragraph 4.42 are applied in place of the less stringent requirements in Article 4.3 of the EU Audit Regulation, as permitted by Article 4.4 of the EU Audit regulation.

4.44 **Where it is expected that the total fees for services receivable from a non-listed entity that is not a *public interest entity* and its subsidiaries relevant to a recurring *engagement* by the *firm* will regularly exceed 15% of the annual fee income of the *firm* or, where profits are not shared on a *firm*-wide basis, of the part of the *firm* by reference to which the *engagement partner's* profit share is calculated, the *firm* shall not act as the provider of the *engagement* for that entity and shall either resign or not stand for reappointment, as appropriate.**

4.45 Where it is expected that the total fees for services receivable from an entity and its subsidiaries relevant to a recurring *engagement* by the *firm* will regularly exceed 10%, in the case of *public interest entities* or other *listed entities*, and 15%, in the case of non-listed entities that are not *public interest entities,* of the annual fee income of the part of the *firm* by reference to which the *engagement partner's* profit share is calculated, it may be possible to assign the *engagement* to another part of the *firm*.

4.46 Paragraphs 4.42 and 4.44 are not intended to require the *firm* to resign as provider of a recurring *engagement*, or not stand for reappointment, as a result of an individual event or *engagement*, the nature or size of which was unpredictable and where an objective, reasonable and informed third party would regard ceasing to act as detrimental to the shareholders (or equivalent) of the entity or otherwise contrary to the public interest. However, in such circumstances, the *engagement partner* discloses full details of the position to the *Ethics Partner*/Function and to those charged with governance of the entity, including the audit committee where there is one, and discusses with both the threats to the integrity, objectivity and independence of the *firm* and *covered persons* and the safeguards applied to eliminate or reduce those threats to a level where independence would not be compromised.

4.47 **Where it is expected that the total fees services receivable from a *public interest entity* or other *listed entity* and its subsidiaries relevant to a recurring *engagement* by the *firm* will regularly exceed 5% of the annual fee income of the *firm* or the part of the *firm* by reference to which the *engagement partner's* profit share is calculated, but will not regularly exceed 10%, the *engagement partner* shall disclose that expectation to the *Ethics Partner*/Function and to those charged with governance of the entity, including the audit committee where there is one, and**

---

[46] Total fees will include those billed by others where the *firm* is entitled to the fees, but will not include fees billed by the *firm* where it is acting as agent for another party.

[47] In the case of a sole practitioner, annual fee income of the *firm* includes all earned income received by the individual.

discusses with both the threat to integrity, objectivity and independence of the *firm* and *covered persons* and whether safeguards need to be applied to eliminate or reduce the threat to a level where independence would not be compromised.

4.48 It is fundamental to the integrity and objectivity of the *firm* and *covered persons* that they be willing and able, if necessary, to disagree with the directors and management, regardless of the consequences to the *firm's* own position. Where the *firm* is, to any significant extent, economically dependent on the entity, this may inhibit the willingness or constrain the *firm*'s ability to express a qualified opinion on the financial statements or other *subject matter information* or *subject matter* of an *engagement*, since this could be viewed as likely to lead to the *firm* losing the *engagement* and the entity as a client.

4.49 A *firm* is deemed to be economically dependent on a *public interest entity* or other *listed entity* if the total fees for all other services from that entity and its subsidiaries relevant to a recurring *engagement* represent 10% of the total fees of the *firm* or the part of the *firm* by reference to which the *engagement partner's* profit share is calculated. Where such fees are between 5% and 10%, the *engagement partner* and the *Ethics Partner*/Function consider the significance of the threat and the need for appropriate safeguards.

4.50 Such safeguards might include:

- taking steps to reduce the other work to be undertaken and therefore the fees earned from the entity;
- applying independent internal quality control reviews.

4.51 **Where it is expected that the total fees for services receivable from a non-listed entity, that is not a *public interest entity,* and its subsidiaries relevant to a recurring *engagement* will regularly exceed 10% of the annual fee income of the *firm* or the part of the *firm* by reference to which the *engagement partner's* profit share is calculated, but will not regularly exceed 15%, the *engagement partner* shall disclose that expectation to the *Ethics Partner*/Function and to those charged with governance of the entity and the *firm* shall arrange an external independent quality control review of the *engagement* to be undertaken before the *firm's* report is finalised.**

4.52 A quality control review involves discussion with the *engagement partner*, a review of the financial statements or other *subject matter information* or *subject matter* of an *engagement* and the *firm's* report thereon, and consideration of whether the report is appropriate. It also involves a review of selected working papers relating to the significant judgments the *engagement team* has made and the conclusions they have reached. The extent of the review depends on the complexity of the *engagement* and the risk that the report might not be appropriate in the circumstances. The review includes considering the following:

- Significant risks identified during the *engagement* and the responses to those risks.
- Judgments made, particularly with respect to materiality and significant risks.
- The *engagement team's* consideration of the entity's compliance with

applicable laws and regulations.

- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
- The significance and disposition of corrected and uncorrected misstatements identified during the *engagement*.
- The appropriateness of the report to be issued.

Where the quality control reviewer makes recommendations that the *engagement partner* does not accept and the matter is not resolved to the reviewer's satisfaction, the report is not issued until the matter is resolved by following the *firm's* procedures for dealing with differences of opinion.

4.53 A new *firm* seeking to establish itself may find the requirements relating to economic dependence difficult to comply with in the short term. In these circumstances, such *firms* would:

(a) not undertake any *engagements* of *public interest entities* or other *listed entities*, where fees from such an entity would represent 10% or more of the annual fee income of the *firm*; and

(b) for a period not exceeding two years, require external independent quality control reviews of those of non-listed entities, that are not *public interest entities*, that represent more than 15% of the annual fee income before the *engagement* report/opinion is issued.

The *firm* might also develop its practice by accepting work from entities not relevant to an *engagement* by the *firm* so as to bring the fees payable by each entity which is relevant to an *engagement* below 15%.

4.54 A self-interest threat may also be created where a partner in the *engagement team*:

- is employed exclusively or principally on that *engagement*; and
- is remunerated on the basis of the performance of part of the *firm* which is substantially dependent on fees from that entity.

4.55 Where the circumstances described in paragraph 4.54 arise, the *firm* assesses the significance of the threat and applies safeguards to reduce the threat to a level where independence would not be compromised. Such safeguards might include:

- reducing the dependence of the office, partner or other *covered person* by reallocating the work within the practice;
- a review by an *engagement partner* with relevant expertise who is not involved with the *engagement* to ensure that the integrity, objectivity or independence of the *firm* and *covered persons* is not affected by the self-interest threat.

Remuneration and Evaluation Policies

4.56D **A *firm* shall have in place adequate remuneration policies, including profit-sharing policies, providing sufficient performance incentives to secure *engagement* quality. In particular, the amount of revenue that the**

***firm* derives from providing *non-audit / additional services* to the entity shall not form part of the performance evaluation and remuneration of any *covered person* involved in, or able to influence the carrying out of, an *engagement*.** [AD 24a.1(j)]

4.57 **The *firm* shall establish policies and procedures to ensure that each of the following is true in relation to each *entity relevant to an engagement* by the *firm*:**

(a) a primary criterion for evaluating the performance or promotion of members of the *engagement team* is how they have contributed to the quality of *engagements* undertaken;

(b) the objectives of the members of the *engagement team* do not include selling *non-audit / additional services* to the entity;

(c) the criteria for evaluating the performance or promotion of members of the *engagement team* do not include success in selling *non-audit / additional services* to the entity; and

(d) no specific element of the remuneration of a member of the *engagement team* is based on his or her success in selling *non-audit / additional services* to the entity.

This requirement does not apply to those members of the *engagement team* from specialist practice areas where the nature and extent of their involvement in the *engagement* is clearly insignificant.

4.58 Where the *firm*, its partners or *staff* identify areas for possible improvement in an *entity relevant to an engagement*, they may provide general business advice, which might include suggested solutions to problems. Before discussing any *non-audit / additional service* that might be provided by the *firm* or effecting any introductions to colleagues from outside the *engagement team*, the *engagement partner* considers the threats that such a service would have on the *engagement*, in line with the requirements in Section 5 of this Ethical Standard, and whether it is probable that an objective, reasonable and informed third party would conclude the integrity, objectivity or independence of the *firm* or *covered persons* are compromised.

4.59 The last sentence of paragraph 4.57 recognises the fact that an *engagement team* may include personnel from specialist practice areas and that it would be inappropriate to limit the business development activities of such persons where their involvement in the *engagement* is clearly insignificant.

4.60 The policies and procedures required for compliance with paragraph 4.57 are not intended to inhibit normal profit-sharing arrangements. However, such policies and procedures are central to the ability of a *firm* that provides *engagement* services to demonstrate the integrity, objectivity and independence of the *firm* and *covered persons*, and to rebut any suggestion that an *engagement* that it has undertaken and the report/opinion that it has given are influenced by the nature and extent of any *non-audit / additional services* that it has provided to that entity. The *Ethics Partner*/Function pays particular attention to the actual implementation of those policies and procedures and is available for consultation when needed.

Gifts and Hospitality

4.61D **A *firm*, its partners and any *covered person*, and *persons closely associated* with them, shall not solicit or accept pecuniary and non-pecuniary gifts or favours, including hospitality, from an *entity relevant to the engagement*, or any other entity related to that entity, unless an objective, reasonable and informed third party would consider the value thereof as trivial or inconsequential.** [AD 22.5]

4.62 Where gifts, favours or hospitality are accepted from an *entity relevant to an engagement*, or from other entities related to that entity, self-interest and familiarity threats to the integrity, objectivity and independence of the *firm*, its partners and any other *covered person* are created. Familiarity threats also arise where gifts, favours or hospitality are offered to an *entity relevant to an engagement*, its partners or any other *covered person*.

4.63 **The *firm* shall establish policies on the nature and value of gifts, favours and hospitality that may be accepted from and offered to an *entity relevant to an engagement*, or any other entity related to that entity, their directors, officers and employees, and shall issue guidance to assist partners and *staff* to comply with such policies.**

4.64 Where gifts, favours and hospitality are accepted or offered more than once, the view of an objective, reasonable and informed third party of the cumulative effect is considered.

4.65 Where there is any doubt as to the acceptability of gifts, favours or hospitality offered by the entity, members of the *engagement team* discuss the position with the *engagement partner*. If there is any doubt as to the acceptability of gifts, favours or hospitality offered to the *engagement partner*, or if the *engagement partner* has any residual doubt about the acceptability of gifts, favours or hospitality to other individuals, the *engagement partner* reports the facts to the *Ethics Partner*/Function, for further consideration regarding any action to be taken.

Threatened and Actual Litigation

4.66 Paragraphs 4.67 and 4.68 below, which support Supporting Ethical Provision 2.11, do not apply to the *engagements* of those entities where the responsibility for the *engagement* is assigned by legislation and the *firm* cannot resign from the *engagement*. In these circumstances the *firm* reports significant litigation to the relevant legislative authority.

4.67 Where litigation (in relation to any services) actually takes place between the *firm*, its partners, or any *covered person*, and the entity or its *affiliates*, or where such litigation is considered probable, self-interest, advocacy and intimidation threats to the integrity, objectivity and independence of the *firm* and *covered persons* are created because the *firm's* interest will be the achievement of an outcome to the dispute or litigation that is favourable to itself. In addition, an effective *engagement* process requires complete candour and full disclosure between the entity's management and the *engagement team*: such disputes or litigation may place the two parties in opposing adversarial positions and may affect management's willingness to make complete disclosure of relevant information. Where the *firm* can foresee

that such a threat may arise and independence compromised, the *firm* informs the audit committee of its intention to resign or, where there is no audit committee, the board of directors. Where applicable, the *firm* also informs any other persons or entities the *firm* is instructed to advise of its intention to withdraw from the *engagement*.

4.68 The *firm* is not required to resign immediately in circumstances where an objective, reasonable and informed third party would not regard it as being in the interests of the shareholders (or equivalent) or otherwise contrary to the public interest. Such circumstances might arise, for example, where:

- the litigation was commenced as the *engagement* was about to be completed, and shareholder (or other stakeholder) interests would be adversely affected by a delay in the *engagement*;
- on appropriate legal advice, the *firm* deems that the threatened or actual litigation is vexatious or designed solely to bring pressure to bear on the opinion to be expressed by the *firm*.

Section 5 – Non-audit / Additional Services

General Approach to Non-audit / Additional Services

Investment Circular Reporting Engagements

5.1 In relation to an *investment circular reporting engagement*, this Section applies only to those *additional services* provided by the *firm* to an *entity relevant to the engagement* during the '*relevant period*'. The *relevant period* covers the period during which the *investment circular reporting engagement* is undertaken and any additional period subsequent to the date of the most recent audited financial statements. Other services provided prior to that date are unlikely to create threats to integrity or objectivity because:

- where the *reporting accountant* undertook the last audit of the financial statements of an *entity relevant to the engagement* and complied with the FRC's Ethical Standard, the requirements applicable to the provision of other services will have been observed; or
- where the last audit of the financial statements of an *entity relevant to the engagement* was undertaken by a different *firm*, the work done by the *reporting accountant* in providing other services will have been the subject of independent review in the course of the audit.

5.2 Paragraphs 5.3 to 5.39 of this Section set out the general approach to be adopted by *firms* in relation to the provision of *non-audit services* to entities audited by them and *additional services* to entities which they may not audit but for which they undertake other public interest assurance services. This approach is applicable irrespective of the nature of the *non-audit / additional services*, which may be in question in a given case. (Paragraphs 5.44 to 5.164 of this Section illustrate the application of the general approach to a number of common *non-audit / additional services*.)

5.3 ISAs (UK) require that auditors exercise professional judgment and maintain professional scepticism throughout the planning and performance of the audit and, among other things:

- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
- Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained[48].

5.4 Judgments regarding the nature and extent of evidence necessary to support an audit opinion or opinion given in respect of an other *public interest assurance engagement* are a matter for the *firm* but will include:

[48] ISA (UK) 200 (Revised June 2016) '*Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK)'* paragraph 7.

- Identifying, evaluating and testing, where appropriate, those internal control systems the effectiveness of which is necessary for the *engagement* and where, if any control weaknesses are identified, extended testing will be required; and
- additional work undertaken to respond to risks identified by management or the audit committee that the *firm* considers could impact the *firm's* opinion on financial statements or on other *subject matter information* or *subject matter* of the *engagement*.

5.5 Other work undertaken by the *engagement team* at the request of management or those charged with governance will not be categorised as part of the *engagement* irrespective of whether it forms part of the *engagement* proposal or *engagement*, unless it is clear that the predominant rationale for the performance of the work in question is to enable a soundly based opinion on the financial statements, or on other *subject matter information* or *subject matter* of the *engagement*, to be expressed. Therefore, an *engagement* does not include work where:

- The objective of that work is not to gather evidence to support the *firm's* opinion on the financial statements or on other *subject matter information* or *subject matter* of the *engagement*; or
- The nature and extent of testing is not determined by the *firm***,** or in the case of a group, the work of other *firms* in relation to group components**,** in the context of expressing an opinion on the financial statements or on other *subject matter information* or *subject matter* of the *engagement*; or
- The principal terms and conditions for the work differ from that of the *engagement*.

5.6 In the context of an *audit engagement*, if additional work on financial information[49] and/or financial controls is authorised by those charged with governance, but the objective of that work is not to enable the auditor to provide an audit opinion on the entity's financial statements, it will be considered as an 'audit related service' (see paragraph 5.40) for the purpose of this Ethical Standard provided that it:

- is integrated with the work performed in the audit and performed largely by the existing *audit team*; and
- is performed on the same principal terms and conditions as the audit.

As a consequence of these factors, any threats to auditor independence arising from the performance of such additional work are considered to be clearly insignificant.

5.7 For entities audited by the *firm*, other additional work that:

- does not relate to financial information and/or financial controls; or
- is not integrated with the work performed in the audit, or is not performed largely by the existing *audit team*, or
- is not on the same principal terms and conditions as the audit;

[49] This does not include *accounting services*.

will be regarded as an 'other *non-audit service*' for the purpose of this Ethical Standard.

5.8 '*Non-audit service*s' comprise any engagement in which a *firm*, or a member of its network, provides professional services to:

- an *audited entity*;
- an *audited entity's affiliates*; or
- another entity where the *subject matter* of the *engagement* includes the *audited entity*[50] and/or its *significant affiliates*;

other than the audit of financial statements of the *audited entity*.

5.9 For a *public interest assurance engagement* other than an audit, '*additional services*' comprise any engagement in which a *firm*, or a member of its *network*, provides professional services to an *entity relevant to the engagement* other than pursuant to:

(a) any other *public interest assurance engagement*;

(b) the audit of financial statements; and

(c) those other roles which legislation or regulation specify can be performed by the auditor of the entity (for example, considering the preliminary announcements of listed companies, complying with the procedural and reporting requirements of regulators, such as requirements relating to the audit of the client's internal controls and reports in accordance with Section 714 of the Companies Act 2006).

Where the *entity relevant to the engagement* is a member of a group, *additional services* for the purposes of this Ethical Standard include:

- services provided by the *firm* to the parent entity or to any of its *significant affiliates*; and
- services provided by a *network firm* which is involved in the *engagement* to the *entity relevant to the engagement* or any of its *significant affiliates*.

5.10 There may be circumstances where the *firm* is engaged to provide a *non-audit / additional service* and where that service and its scope are determined by an entity which is not audited or relevant to an other *public interest assurance engagement* by the *firm*. However, it might be contemplated that an *entity relevant to an engagement*, may gain some benefit from that *non-audit / additional service*[51]. In some circumstances, there may be no threat to the integrity, objectivity and independence of the *firm* and *covered persons* at the time of appointment. However, the *firm* considers how the *non-audit / additional service* may be expected to develop, whether there are any threats that the *firm* may be subject to if additional relevant parties which are *entities*

---

[50] For example, where an engagement is undertaken to assist in the preparation of listing particulars for a company acquiring the *audited entity*

[51] For example, in a vendor due diligence engagement, the engagement is initiated and scoped by the vendor before the purchaser is identified. If an entity audited by the *firm* undertaking the due diligence engagement is the purchaser, that *audited entity* may gain the benefit of the report issued by its auditor, it may be a party to the engagement letter and it may pay an element of the fee.

relevant to an engagement, are identified, and whether any safeguards need to be put in place. For example, when the results of such a *non-audit / additional service* performed by the *firm* are reflected in the financial statements or other *subject matter information* or *subject matter* of an *engagement*; or where the fees earned from such a *non-audit / additional service* performed by the *firm* could be perceived as compromising independence for an *engagement* by the *firm*.

5.11 **The *firm* shall establish policies and procedures that require others within the *firm*, when considering whether to provide a *non-audit / additional service* to an *entity relevant to an engagement*, other than an *investment circular reporting engagement*, or to any of its *affiliates*, to communicate details of the proposed *non-audit / additional service* to the *engagement partner*.**

5.12 The *firm* establishes appropriate channels of internal communication to ensure that, in relation to an *entity relevant to an engagement*, the *engagement partner* (or their delegate) is informed about any proposed *non-audit / additional service* to the entity or any of its *affiliates* and that he or she considers the implications for the integrity, objectivity and independence of the *firm* and *covered persons* before provision of the *non-audit / additional service* is accepted. Additionally, when addressing services provided to another entity in respect of an *entity relevant to an engagement*, the procedures address any requirement to preserve client confidentiality.

5.13 In the case of a group audit of a *public interest entity* or an other *listed entity* the group *engagement partner* establishes that the entity has communicated its policy on the engagement of the external auditor to supply *non-audit services* to its *affiliates* and obtains confirmation that the auditors of the *affiliates* will comply with this policy.[52] The group *engagement partner* also requires that relevant information on *non-audit services* provided by *network firms* is communicated on a timely basis.

5.14 **In relation to *investment circular reporting engagements*, the *firm* should establish policies and procedures, including the alternative procedures outlined in paragraph 1.40 of Section 1 of Part B of this Ethical Standard, that enable it to identify circumstances where others within the *firm* and *network firms* involved in the *investment circular reporting engagement* have undertaken to provide during the *relevant period*, an *additional service* to an *entity relevant to the engagement* or any of that entity's *significant affiliates*.**

5.15 The *firm* establishes appropriate policies and procedures to ensure that, in relation to an *entity relevant to an investment circular reporting engagement*, any undertaking to provide an *additional service* to the entity, or any of its *significant affiliates*, during the *relevant period* is identified, so that the *engagement partner* can consider the implications for integrity, objectivity and independence of the *firm* and *covered persons* before the *investment circular reporting engagement* is accepted. Such policies and procedures are likely to involve:

(i) enquiries of each *entity relevant to the engagement*;

[52] The UK Corporate Governance Code requires audit committees to develop the company's policy on the engagement of the external auditor to supply *non-audit services*.

(ii) reference to records of past and current *additional services* provided by the *firm*;

(iii) enquiries of *network firms* involved in the *investment circular reporting engagement* as to whether they have provided any *additional services* to an *entity relevant to the engagement* or any of its *significant affiliates* during the *relevant period*.

Such enquiries are undertaken in a manner which seeks to protect confidentiality.

Identification and Assessment of Threats and Safeguards

5.16 **For an *engagement* other than an *investment circular reporting engagement*, before the *firm* accepts to provide a *non-audit / additional service* to an *entity relevant to the engagement*, the *engagement partner* shall:**

(a) identify and assess the significance of any related threats to the integrity or objectivity of the *firm* and *covered persons*, including whether independence would be compromised; and

(b) identify and assess the effectiveness of the available safeguards to eliminate the threats or reduce them to a level where independence would not be compromised; and

(c) consider whether it is probable that an objective, reasonable and informed third party, having regard to the threats and safeguards, would conclude that that the proposed *non-audit / additional service* would not impair integrity or objectivity and compromise the independence of the *firm* or *covered persons*.

5.17 When assessing the significance of threats to the integrity, objectivity and independence of the *firm* and *covered persons*, the *engagement partner* considers the following factors:

- The likely relevance and impact of the *non-audit / additional service* on the financial statements, or on *subject matter information* or *subject matter* of the *engagement*;
- The extent to which performance of the proposed *non-audit / additional service* will involve the exercise of professional judgment;
- The size of the *non-audit / additional service* and the associated fee;
- The basis on which the fee is to be calculated;
- The *staff* who would be carrying out the *non-audit / additional service*[53];
- The staff from the *entity relevant to the engagement* who would be involved in the *non-audit / additional service*[54].

[53] For example, where those handling the *non-audit service* are particularly expert so that the *audit team* (or persons advising it) may have difficulty in reviewing effectively the advice given or the work undertaken by the *non-audit service* team in the course of conducting a subsequent audit, with the result that the effectiveness of the audit might be compromised.

[54] For example, the safeguards necessary to address any self-review threat will require careful consideration where those involved are particularly senior and can be expected to be actively involved in any audit discussion as this may also create an intimidation threat.

To ensure that this assessment is made with a proper understanding of the nature of the *non-audit / additional service*, it may be necessary to refer to a draft engagement letter in respect of the proposed *non-audit / additional service* or to discuss the service with the partner involved.

5.18 The assessment of the threats to the integrity, objectivity and independence of the *firm* and *covered persons* arising from any particular *non-audit / additional service* is a matter for the *engagement partner* responsible for the *engagement*. The *engagement partner* may decide to delegate some information gathering activities to senior personnel on the *engagement team* and may allow such personnel to make decisions in relation to routine *non-audit / additional services*. If this is the case, the *engagement partner* will:

- provide specific criteria for such decisions that reflect both the requirements of this Ethical Standard and the entity's policy for the purchase of *non-audit / additional services*; and
- monitor the decisions being made on a regular basis.

5.19 Where the *engagement partner* is not able to undertake the assessment of the significance of threats in relation to a proposed *non-audit / additional service* to an *entity relevant to an engagement*, for example due to illness or holidays, alternative arrangements are established (for example, by authorising the *engagement quality control reviewer* to consider the proposed service).

5.20 **For an *engagement* other than an *investment circular reporting engagement*, where it is probable that an objective, reasonable and informed third party would conclude that the proposed *non-audit / additional service* would impair integrity or objectivity and compromise the independence of the *firm* or *covered persons*, the *firm* shall either:**

(a) not undertake the *non-audit / additional service*; or

(b) not accept or shall withdraw from the *engagement* as appropriate.

5.21 **For an *investment circular reporting engagement*, where the *engagement partner* considers that it is probable that a reasonable and informed third party would regard the objectives of an additional service[55] undertaken during the *relevant period* as being inconsistent with the objectives of the *investment circular reporting engagement*, the *firm* shall not accept or shall withdraw from the *investment circular reporting engagement* as appropriate.**

5.22 The objectives of *non-audit / additional services* vary and depend on the specific terms of the service. In some cases these objectives may be inconsistent with those of an *audit engagement* or other *public interest assurance engagement* provided by the *firm* and, in such cases, this may give rise to a threat to the integrity or objectivity of the *firm* and *covered persons* and to the appearance of their independence.

[55] This includes consideration of any private reporting engagements associated with the transaction which is the subject of the *investment circular* that were undertaken before the *investment circular* was contemplated.

5.23 Similarly, in relation to a possible appointment as provider of an *audit engagement* or other *public interest assurance engagement* to an entity that the *firm* has not provided such an *engagement* before, consideration needs to be given to recent, current and potential *non-audit / additional services* provided by the *firm* to the entity. The *firm* does not accept appointment to undertake such an *engagement* unless it is probable that an objective, reasonable and informed third party, taking into account safeguards applied, would conclude that the independence of the *firm* or *covered persons* are not compromised.

5.24 The passage of time since a service was provided, and audit or review of the outcome of the service by another *firm*, may help mitigate actual and perceived threats to independence. However, it is still necessary for an assessment of the threats to be undertaken in accordance with paragraph 1.33 of Section 1 of Part B of this Ethical Standard before an *engagement* is accepted. Such an assessment takes account of the nature of the service and significance of the outcome provided to the proposed *engagement* and whether an objective, reasonable and informed third party, taking into account safeguards applied, would conclude that the independence of the *firm* or *covered persons* are not compromised.

5.25 When tendering for a new *investment circular reporting engagemen*t or, in the case of *public interest entities* and other *listed entities*, when tendering for a new *audit engagement* or other *public interest assurance engagement*, the *firm* ensures that relevant information on recent *non-audit / additional services* is drawn to the attention of the audit committee (or those charged with governance if the entity does not have an audit committee) and, where applicable, any other persons or entities the *firm* is instructed to advise, including:

- when recent *non-audit / additional services* were provided;
- the materiality of those *non-audit / additional services* to the proposed *engagement*;
- whether those *non-audit / additional services* would have been prohibited if the entity had been an *entity relevant to an engagement* by the *firm* at the time when they were undertaken; and
- the extent to which the outcomes of *non-audit / additional services* have been audited or reviewed by another *firm*.

Threats to Objectivity and Independence

5.26 As identified in Section 1, the principal types of threats to the integrity, objectivity and independence of the *firm* and *covered persons* are:

- self-interest threat;
- self-review threat;
- management threat;
- advocacy threat;
- familiarity (or trust) threat; and
- intimidation threat.

The *firm*, its partners and *staff* remain alert to the possibility that any of these threats may occur in connection with *non-audit / additional services*. However, the threats most commonly associated with *non-audit / additional services* are self-interest threat, self-review threat, management threat and advocacy threat (see paragraph 1.29 of Section 1 of Part B of this Ethical Standard).

Safeguards

5.27 Where any threat to the integrity and objectivity of the *firm* or any *covered person* and the appearance of their independence is identified, the *engagement partner* assesses the significance of that threat and considers whether there are safeguards that could be applied and which would be effective to eliminate the threat or reduce it to a level where independence is not compromised. If such safeguards can be identified and are applied, the *non-audit / additional service* may be provided. However, where no such safeguards are applied, the only course is for the *firm* either not to undertake the *non-audit / additional service* in question or not to accept or to withdraw from the *engagement*.

5.28 When considering what safeguards, if any, would be effective in reducing the threats to integrity, objectivity and independence to a level where independence is not compromised, the *engagement partner* has regard to the following safeguards which, individually or in combination, may be effective, depending on the circumstances:

(a) The *non-audit / additional services* are provided by a separate team from the *engagement team*, and:

- if circumstances require, to address the threat identified, there is effective physical and electronic segregation of the individuals in each team, and of their documentation, at all times during the provision of the *engagement* and *non-audit / additional services*; and/or
- the team providing the *non-audit / additional services* avoids taking any action or making any statement that compromises the integrity or objectivity and independence of the *engagement team*, for example, expressing any opinion about the approach that the *engagement team* might take or the conclusion it might reach when considering the appropriateness of accounting or other judgments.

The *Ethics Partner* establishes policies and procedures to ensure that, where safeguards of this nature are considered appropriate, the arrangements put in place are effective at all times. This will involve the *Ethics Partner*/Function being satisfied that there are effective arrangements in place for each member of the *non-audit / additional services* team to acknowledge their responsibilities and for each member of the *engagement team* to notify him or her of any breach of this requirement that the team member becomes aware of. Where notified of a breach, the *Ethics Partner*/Function considers together with the *engagement partner* the significance of the breach and the implications for the integrity, objectivity and independence of the *engagement team*, including whether any further safeguards are necessary and whether the matter should be reported to those charged with governance of the entity;

(b) The *engagement quality control reviewer*, or another partner of sufficient relevant experience and seniority who is, and is seen to be, an effective challenge to both the *engagement partner* and the partner leading the *non-audit / additional services*, reviews the work and conclusions of the *engagement team*. The review includes consideration of the judgments of the persons conducting the *engagement*, if any, relating to the *subject matter* of the *non-audit / additional service*, having regard to the self-review threat identified, and determines and documents his or her conclusions as to whether the work is sufficient and the conclusions of the *engagement team* are appropriate. Where the review partner has concerns, the *engagement partner* does not sign the engagement opinion/report until those concerns have been subject to full consultation, including escalation through any processes required by the *firm's* policies. Where this safeguard is considered appropriate, the *Ethics Partner*/Function is satisfied that the review partner undertaking this role is appropriate, that the review partner is aware of the circumstances leading to the conclusion that there is a significant self-review threat and that any concerns raised by the review partner have been satisfactorily resolved before signature of the opinion.

5.29 **For an *engagement* other than an *investment circular reporting engagement*, where the *engagement partner* concludes, with respect to threats to the integrity or objectivity of the *firm* or *covered persons*, including any threats that could compromise independence, related to a proposed *non-audit / additional service* to an *entity relevant to the engagement*, that no appropriate safeguards are available to eliminate or reduce such threats to a level where independence would not be compromised, he or she shall inform the others concerned within the *firm* of that conclusion and the *firm* shall either:**

(a) not undertake the *non-audit / additional service*; or

(b) not accept or shall withdraw from the *engagement* as appropriate.

If the *engagement partner* is in doubt as to the appropriate action to be taken, he or she shall resolve the matter through consultation with the *Ethics Partner*/Function.

5.30 An initial assessment of the threats to integrity, objectivity and independence and the safeguards to be applied is required when the *engagement partner* is considering the acceptance of a *non-audit / additional service*. The assessment of the threats and the safeguards applied is reviewed whenever the scope and objectives of the *non-audit / additional service* change significantly. If such a review suggests that safeguards cannot reduce the threat to a level where independence would not be compromised, the *firm* withdraws from the *non-audit / additional service*, or does not accept or withdraws from the *engagement* as appropriate.

5.31 **Where both an *investment circular reporting engagement* and an engagement to undertake other services are provided concurrently, the initial assessment of the threats to objectivity and independence and the safeguards to be applied shall be reviewed whenever the scope and objectives of the other service or the *investment circular reporting engagement* change significantly. If such a review suggests that safeguards cannot reduce the threat to a level where independence is**

not compromised, the *firm* shall withdraw from the other service, or withdraw from the *investment circular reporting engagement*.

5.32 Where there is doubt as to the appropriate action to be taken, consultation with the *Ethics Partner*/Function ensures that an objective judgment is made and the *firm's* position is consistent.

Communication with Those Charged With Governance

5.33 Transparency is a key element in addressing the issues raised by the provision of *non-audit / additional services* by *firms* to the entities audited by them or for which other public interest assurance services are provided. Paragraphs 1.61, 1.66 and 1.67 of Section 1 of part B of this Ethical Standard establish requirements to communicate to those charged with governance, and other persons where appropriate, significant facts and matters that may bear upon the integrity, objectivity and independence of the *firm*. These include relevant facts and matters related to the provision of *non-audit / additional services*.

5.34 In the case of *public interest entities* and other *listed entities*, and entities that may be seeking a listing, ensuring that the audit committee is properly informed about the issues associated with the provision of *non-audit services* will assist them to comply with the provisions of the UK Corporate Governance Code relating to reviewing and monitoring the external auditor's independence and objectivity and to developing a policy on the use of the external auditor to supply *non-audit services*. This will include discussion of any inconsistencies between the entity's policy and this Ethical Standard and ensuring that the policy is communicated to *affiliates*.

5.35 Communications with those charged with governance regarding the impact on the integrity, objectivity or independence of the *firm* and *covered persons* of *non-audit / additional services* are likely to be facilitated if disclosure of such *non-audit / additional services* distinguishes between 'audit related services' (see paragraphs 5.40 – 5.43) and other *non-audit / additional services* (see paragraphs 5.8 and 5.9).

Documentation

5.36 **For an *engagement* other than an *investment circular reporting engagement*, the *engagement partner* shall ensure that the reasoning for a decision to provide *non-audit / additional services*, and any safeguards adopted and why they are effective, is appropriately documented.**

5.37 Matters to be documented include any significant judgments concerning:

- threats identified;
- safeguards adopted and the reasons why they are considered to be effective; and
- communication with those charged with governance.

5.38 In situations where a management threat is identified in connection with the provision of *non-audit / additional services*, this documentation will include the assessment of the persons conducting the *engagement* of whether there is

informed management. The documentation of communications with the entity where judgments and decisions are made by management may take a variety of forms, for example an informal meeting note covering the matters discussed.

5.39 For an *investment circular reporting engagement* the *engagement partner*, in accordance with paragraph 1.73 of Section 1 of Part B of this Ethical Standard, ensures that his or her consideration of the integrity, objectivity and independence of the *firm* and *covered persons* is appropriately documented on a timely basis. This includes consideration of non-audit/additional services provided during the *relevant period*.

Audit Related Services

5.40 Audit related services are those *non-audit services* specified in this Ethical Standard that are largely carried out by members of the *audit engagement team*, and where the work involved is closely related to the work performed in the audit and the threats to auditor independence are clearly insignificant and, as a consequence, safeguards need not be applied. However, such services provided to *public interest entities*, other than those required by Union or national legislation, are still subject to the 70% cap (see paragraphs 4.34R and 4.35R of Section 4 of Part B of this Ethical Standard) and still require approval by the audit committee.

5.41 Audit related services are:

- Reporting required by law or regulation to be provided by the auditor;
- Reviews of interim financial information;
- Reporting on regulatory returns;
- Reporting to a regulator on client assets:
- Reporting on government grants;
- Reporting on internal financial controls when required by law or regulation;
- Extended audit work that is authorised by those charged with governance performed on financial information[56] and/or financial controls where this work is integrated with the audit work and is performed on the same principal terms and conditions.

5.42 **The *engagement partner* shall ensure that only those *non-audit services* listed in paragraph 5.41 are described as audit related services in communications with those charged with governance of the *audited entity*.**

5.43 In the UK, legislation requires large companies to disclose fees receivable by their auditors and their auditors' associates (see the Appendix to this Ethical Standard). The specified categories of disclosure include "audit related assurance services", which will only include those services which are identified as audit related services in paragraph 5.41 above.

[56] This does not include *accounting services*.

Evaluation of Specific Non-audit Services and Additional Services

5.44 There are services other than 'audit related services' (see paragraphs 5.40 – 5.43) for which it is generally accepted that the auditor of the entity is an appropriate provider. However the threats to independence arising from such services are not necessarily clearly insignificant and the *firm* considers whether such services give rise to threats to independence and, where appropriate, the need to apply safeguards. Such services include:

- Reports, that are not 'audit related services', required by the competent authorities / regulators supervising the *audited entity*, where the authority / regulator has either specified the auditor to provide the service or identified to the entity that the auditor would be an appropriate choice for service provider. These might include, for example:
    - in relation to entities regulated under the Financial Services and Markets Act 2000 (FSMA), reports under s166 and s340 of FSMA; and
    - other reports provided for under the rules of a competent authority / regulator.
- Audit and other services provided as auditor of the entity, or as *reporting accountant*, in relation to information of the *audited entity* for which it is probable that an objective, reasonable and informed third party would conclude that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service, and where the nature of the service would not compromise independence. These might include, for example:
    - audit and other services relating to public reporting as *reporting accountant* on financial or other information of the *audited entity* in a prospectus or circular (including reports that may be required by the Prospectus Rules, the Listing Rules and the Take Over Code);
    - services, including private reporting, that are customarily performed by the *reporting accountant* to support statements made by the directors, disclosures in a prospectus or circular or, in the case of premium listed issuers, to support confirmations provided by the sponsor to the FCA;
    - audit and other assurance services relating to public reporting on other information issued by the entity, such as reports on information in the front of annual reports not covered by the auditor's report on the financial statements.

The above list is not intended to be fully comprehensive and does not preclude other services being provided. Such services provided to *public interest entities*, other than those required by Union or national legislation, are still subject to the 70% cap (see paragraphs 4.34R and 4.35R of Section 4 of Part B of this Ethical Standard) and still require approval by the audit committee.

5.45 In evaluating threats to compliance with the overarching principles of integrity, objectivity and independence arising from the provision of *non-audit / additional services*, the requirements and guidance below apply to all entities as indicated *relevant to an engagement*. This includes for *public interest entities* and their *significant affiliates* where applicable. Where a more stringent requirement for an audited *public interest entity* is established in

paragraph 5.167R below, that more stringent requirement must be complied with.

5.46 For example, with regards to valuation services, paragraph 5.67 requires that the *firm* shall not provide such services to a *listed entity* that is not an *SME listed entity*, or a *significant affiliate* of such an entity, where the valuation would have a material effect on the *listed entity's* financial statements being audited, or on other *subject matter information* or *subject matter* of the *engagement* in the case of an other *public interest assurance engagement*, either separately or in aggregate with other valuations provided. Where the *listed entity* is also a *public interest entity* audited by the *firm*, paragraph 5.167R prohibits the provision of valuation services, subject to the derogation in paragraph 5.168R, including that the service has no direct or, in the view of an objective, reasonable and informed third party, would have an inconsequential effect, separately or in the aggregate on the audited financial statements of the *public interest entity*.

5.47 **For the purpose of the requirements below, an '*SME listed entity'* is:**

(a) An entity whose equity *financial instruments* had an average market capitalisation of less than €200m on the basis of year end quotes for the previous three calendar years; or

(b) An entity that issues exclusively non-equity *financial instruments* if:

(i) the total nominal amount of the non-equity *financial instruments* issued and outstanding does not exceed €200m; or

(ii) according to the last annual or consolidated accounts, meets at least two of the following criteria:

- **an average number of employee during the financial year of less than 250;**
- **a total balance sheet not exceeding €43m;**
- **an annual net turnover not exceeding €50m.**

An entity whose equity *financial instruments* have been admitted to trading for less than three years shall be deemed an SME if its market capitalisation is below €200m based on:

(a) the closing share price of the first day of trading, if its shares have been admitted to trading for less than one year;

(b) the last closing share price of the first year of trading, if its *financial instruments* have been admitted to trading for more than one year but less than two years; or

(c) the average of the last closing share prices of each of the first two years of trading, if its *financial instruments* have been admitted to trading for more than two years but less than three years.

Internal Audit Services

5.48 The range of 'internal audit services' is wide and they may not be termed as such by an *entity relevant to an engagement*. For example, the *firm* may undertake:

- to outsource the entity's entire internal audit function; or
- to supplement the entity's internal audit function in specific areas (for example, by providing specialised technical services or resources in particular locations); or
- to provide occasional internal audit services to the entity on an ad hoc basis.

All such services would fall within the term 'internal audit services'.

5.49 The nature of possible internal audit services is also wide. While the internal audit remit will vary from entity to entity, it often involves compliance and assurance activities designed to assess the design and operating effectiveness of existing or proposed systems or controls and advisory activities where advice is given to an entity on the design and implementation of risk management, control and governance processes.

5.50 The nature and extent of the threats to the *firm's* independence when undertaking internal audit services vary depending on the nature of the services provided. The main threats to the integrity, objectivity and independence of the *firm* and *covered persons* arising from the provision of internal audit services are the self-review threat and the management threat. Generally these will be lower for activities that are primarily designed to provide assurance to those charged with governance, for example that internal controls are operating effectively, than for advisory activities designed to assist the entity in improving the effectiveness of its risk management, control and governance processes.

5.51 Internal audit services - other than those prohibited in paragraph 5.53 - may be undertaken, provided that the *firm* is satisfied that there is *informed management* (see paragraph 1.29 of Section 1 of Part B of this Ethical Standard) and appropriate safeguards are applied to reduce the self-review threat to a level where independence is not compromised.

5.52 Examples of safeguards that may be appropriate when internal audit services are provided to an *entity relevant to an engagement* include ensuring that:

- internal audit projects undertaken by the *firm* are performed by partners and *staff* who have no involvement in the *engagement*;
- the *engagement* is reviewed by partner with relevant expertise who is not involved in the *engagement*, to ensure that the internal audit work performed by the *firm* has been properly and effectively assessed in the context of the *engagement*.

5.53 **The *firm* shall not provide internal audit services to an *entity relevant to an engagement* where it is reasonably foreseeable that:**

(a) for the purposes of the *engagement*, the *firm* would place significant reliance on the internal audit work performed by the *firm*; or

(b) where the *firm* is undertaking an *engagement* other than an *investment circular reporting engagement*, for the purposes of the internal audit services, the *firm* would undertake part of the role of management; or

(c) where the *firm* is undertaking an *investment circular reporting engagement*, for the purposes of the internal audit services, the *firm* would undertake part of the role of management in relation to the transaction or the financial information that is the subject of the *investment circular reporting engagement*.

For audits of *public interest entities* the prohibition established in paragraph 5.167R(h) must also be complied with.

5.54 The self-review threat is unacceptably high where substantially all of the internal audit activity is outsourced to the *firm* and this is significant to the entity or the *firm* cannot perform the *engagement* without placing significant reliance on the work performed for the purposes of the internal audit service. In the case of *listed entities* that are not SME *listed entities*, the provision of internal audit services in relation to the following examples is likely to be unacceptable as the *engagement team* is likely to place significant reliance on the work performed by the internal audit team in relation to the entity's internal financial controls:

- a significant part of the internal controls over financial reporting;
- financial accounting systems which generate information that is significant to the entity's accounting records;
- amounts or disclosures that are material to the financial statements of the entity or to other *subject matter information* or *subject matter* of the *engagement*.

Where the *firm* is undertaking an *investment circular reporting engagement*, the above examples are relevant where they involve the *firm* taking decisions in relation to the transaction or the financial information that is the *subject matter* of the *investment circular reporting engagement*.

5.55 The management threat is unacceptably high where the *firm* provides internal audit services that involve *firm* personnel taking decisions or making judgments, which are properly the responsibility of management. For example, such situations arise where the internal audit function is outsourced to the *firm* and this is significant to the entity or where the nature of the internal audit work involves:

- Taking decisions on the scope and nature of the internal audit services to be provided to the entity;
- Designing internal controls or implementing changes thereto;
- Taking responsibility for risk management decisions;

- Undertaking work to evaluate the cost effectiveness of activities, systems and controls;
- Undertaking pre-implementation work on non-financial systems.

Where the *firm* is undertaking an *investment circular reporting engagement*, the above examples are relevant where they involve the *firm* taking decisions in relation to the transaction or the financial information that is the *subject matter* of the *investment circular reporting engagement*.

5.56 During the course of the *engagement*, the persons conducting the *engagement* may evaluate the design and test the operating effectiveness of some of the entity's internal financial controls, and the operation of any relevant internal audit function, and provide management with observations on matters that have come to their attention, including comments on weaknesses in the internal control systems and/or the internal audit function together with suggestions for addressing them. This work is a by-product of the *engagement* rather than the result of a separate undertaking to provide *non-audit services* and therefore does not constitute internal audit services for the purposes of this Ethical Standard.

5.57 In some circumstances, additional work is undertaken to respond to risks identified by management or those charged with governance. Where the persons conducting the *engagement* consider that such risks could impact their opinion on the financial statements, or on other *subject matter information* or *subject matter* of the *engagement*, such work is considered to be *engagement* work for the purposes of this Ethical Standard (see paragraphs 5.6 and 5.7). Where the risks do not impact the opinion, whether it is appropriate for such work to be undertaken by the *firm* will depend on the extent to which it gives rise to a threat to the integrity, objectivity or independence of the *firm* and *covered persons*. The *engagement partner* reviews the scope of the objectives of the proposed work and assesses the threats to which it gives rise and the safeguards available.

5.58 If extended audit work on financial information and/or financial controls is authorised by those charged with governance, it will be considered as an 'audit related service' (see paragraphs 5.40 – 5.43) provided that it is integrated with the work performed in the audit and performed largely by the existing *audit team*, and is performed on the same principal terms and conditions as the audit.

5.59 Additional work will not be considered an 'audit related service' if it:

- does not relate to financial information and/or financial controls; or
- is not authorised by those charged with governance; or
- is not integrated with the work performed in the audit, or is not performed largely by the existing *audit team*; or
- is not on the same principal terms and conditions as the audit.

In such circumstances the threats and the safeguards will be communicated to those charged with governance. The *engagement partner* reviews the scope and objectives of the proposed work and assesses the threats to which it gives rise and the safeguards available. Whether it is appropriate for this

work to be undertaken by the *audit firm* will depend on the extent to which it gives rise to threats to the auditor's integrity, objectivity or independence.

Information Technology Services

5.60 Design, provision and implementation of information technology (including financial information technology) systems by *firms* for an *entity relevant to an engagement* creates threats to the integrity, objectivity and independence of the *firm* and *covered persons*. The principal threats are the self-review threat and the management threat.

5.61 Design, provision or implementation of information technology systems that are not important to any significant part of the accounting system or to the production of the financial statements audited by the *firm*, or other *subject matter information* or *subject matter* of the *engagement* in the case of an other *public interest assurance engagement*, and do not have significant reliance placed on them by the persons conducting the *engagement*, may be undertaken, provided that there is *informed management* (see paragraph 1.29 of Section 1 of Part B of this Ethical Standard) and appropriate safeguards are applied to reduce the self-review threat to a level where independence is not compromised.

5.62 Examples of safeguards that may be appropriate when information technology services are provided to an *entity relevant to an engagement* include ensuring that:

- information technology projects undertaken by the *firm* are performed by partners and *staff* who have no involvement in the *engagement*;
- the work undertaken in the course of the *engagement* is reviewed by a partner with relevant expertise who is not involved in the *engagement* to ensure that the information technology work performed has been properly and effectively assessed in the context of the *engagement*.

5.63 **The *firm* shall not design, provide or implement information technology systems for an *entity relevant to an engagement* where:**

(a) the systems concerned would be important to any significant part of the accounting system or to the production of the financial statements audited by the *firm*, or of other *subject matter information* or *subject matter* of the *engagement* in the case of an other *public interest assurance engagement*, and the persons conducting the *engagement* would place significant reliance upon them as part of the *engagement*; or

(b) where the *firm* is undertaking an *engagement* other than an *investment circular reporting engagement*, for the purposes of the information technology services, the *firm* would undertake part of the role of management; or

(c) where the *firm* is undertaking an *investment circular reporting engagement*, for the purposes of the information technology services, the *firm* would undertake part of the role of management in relation to the transaction or the financial information that is the subject of the *investment circular reporting engagement*.

For audits of *public interest entities* the prohibition established in paragraph 5.167R(e) must also be complied with.

5.64 Where it is reasonably apparent that, having regard to the activities and size of the entity and the range and complexity of the proposed system, management lacks the expertise required to take responsibility for the systems concerned, it is unlikely that any safeguards would be sufficient to eliminate these threats or to reduce them to a level where independence is not compromised. In particular, formal acceptance by management of the systems designed and installed by the *firm* is unlikely to be an effective safeguard when, in substance, the *firm* has been retained by management as experts and makes important decisions in relation to the design or implementation of systems of internal control and financial reporting that is the subject of the *engagement*.

5.65 The provision and installation of information technology services associated with a standard 'off the shelf accounting package' (including basic set-up procedures to make the package operate on the entity's existing platform and peripherals, setting up the chart of accounts and the entry of standard data such as the entity's product names and prices) is unlikely to create a level of threat to the integrity, objectivity and independence of the *firm* and *covered persons* that cannot be addressed through applying appropriate safeguards.

Valuation Services

5.66 A valuation comprises the making of assumptions with regard to future developments, the application of appropriate methodologies and techniques, and the combination of both to compute a certain value, or range of values, for an asset, a liability or for a business as a whole.

5.67 **The *firm* shall not provide a valuation service to:**

(a) a *listed entity relevant to an engagement* that is not an *SME listed entity* (see paragraph 5.47), or a *significant affiliate* of such an entity, where the valuation would have a material effect on the *listed entity's* financial statements, or other *subject matter information* or *subject matter* of the *engagement*, either separately or in aggregate with other valuations provided; or

(b) any other *entity relevant to an engagement*, where the valuation would both involve a significant degree of subjective judgment and have a material effect on the financial statements or other *subject matter information* or *subject matter* of the *engagement*, either separately or in aggregate with other valuations provided.

For audits of *public interest entities* the prohibition established in paragraph 5.167R(f) must also be complied with, subject to the derogation provided for in paragraph 5.168R.

5.68 The main threats to the integrity, objectivity and independence of the *firm* and *covered persons* arising from the provision of valuation services are the self-review threat and the management threat. In all cases, the self-review threat is considered too high to allow the provision of valuation services which involve the valuation of amounts with a significant degree of subjectivity and that may have a material effect on financial statements subject to an *audit*

engagement, or on other *subject matter information* or *subject matter* of the *engagement* in the case of an other *public interest assurance engagement*.

5.69 For *listed entities* that are not SME *listed entities*, or *significant affiliates* of such entities, the threats to integrity, objectivity and independence that would be perceived to be created are too high to allow the *firm* to undertake any valuation that has a material effect on the *listed entity's* financial statements being audited, or on other *subject matter information* or *subject matter* of the *engagement* in the case of an other *public interest assurance engagement*.

5.70 The *firm's* policies and procedures will set out whether there are circumstances in which valuation services are not undertaken for non-listed entities as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

5.71 In circumstances where the *firm* is designated by legislation or regulation as being required to carry out a valuation the restrictions in paragraph 5.67 do not apply. In such circumstances, the *engagement partner* applies appropriate safeguards to reduce threats to integrity, objectivity and independence to a level where independence is not compromised.

5.72 It is usual for the persons conducting an *audit engagement* or *investment circular reporting engagement* (and in some cases other *public interest assurance engagements*) to provide management with accounting advice in relation to valuation matters that have come to the attention of persons conducting the *engagement* during the course of the *engagement*. Such matters might typically include:

- comments on valuation assumptions and their appropriateness;
- errors identified in a valuation calculation and suggestions for correcting them;
- advice on accounting policies and any valuation methodologies used in their application.

Advice on such matters does not constitute valuation services for the purpose of this Ethical Standard.

5.73 Where the *firm* is engaged to collect and verify the accuracy of data to be used in a valuation to be performed by others, such engagements do not constitute valuation services under this Ethical Standard.

Actuarial Valuation Services

5.74 **The *firm* shall not provide actuarial valuation services to:**

(a) a *listed entity relevant to an engagement* that is not an *SME listed entity* (see paragraph 5.47), or a *significant affiliate* of such an entity, unless the *firm* is satisfied that the valuation has no material effect on the *listed entity's* financial statements, or other *subject matter information* or *subject matter* of the *engagement*, either separately or in aggregate with other valuations provided; or

(b) any other *entity relevant to an engagement*, unless the *firm* is satisfied that either all significant judgments, including the assumptions, are made by *informed management* or the valuation

has no material effect on the financial statements, or other *subject matter information* or *subject matter* of the *engagement*, either separately or in aggregate with other valuations provided.

For audits of *public interest entities* the prohibition established in paragraph 5.167R(f) must also be complied with, subject to the derogation provided for in paragraph 5.168R.

5.75 Actuarial valuation services are subject to the same general principles as other valuation services. In all cases, where they involve the *firm* in making a subjective judgment and have a material effect on the financial statements subject to an audit, or other *subject matter information* or *subject matter* of the *engagement* in the case of an other *public interest assurance engagement*, actuarial valuations give rise to an unacceptable level of self-review threat and so may not be performed by *firms* for *entities relevant to an engagement*.

5.76 In the case of non-listed entities that are not *public interest entities,* where all significant judgments concerning the assumptions, methodology and data for the actuarial valuation are made by '*informed management*' and the *firm's* role is limited to applying proven methodologies using the given data, for which the management takes responsibility, it may be possible to establish effective safeguards to protect the integrity, objectivity and independence of the *firm* and *covered persons*.

5.77 For *listed entities* that are not *SME listed entities*, or *significant affiliates* of such entities, the threats to integrity, objectivity and independence that would be perceived to be created are too high to allow the *firm* to undertake any actuarial valuation unless the *firm* is satisfied that the valuation has no material effect on the *listed entity's* financial statements being audited, or other *subject matter information* or *subject matter* of the *engagement* in the case of an other *public interest assurance engagement*.

5.78 The *firm's* policies and procedures will set out whether there are circumstances in which actuarial valuation services are not undertaken for non-listed entities as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

Tax Services

5.79 The range of activities encompassed by the term 'tax services' is wide. They include where the *firm*:

(a) provides advice to the entity on one or more specific matters at the request of the entity; or

(b) undertakes a substantial proportion of the tax planning or compliance work for the entity; or

(c) promotes tax structures or products to the entity, the effectiveness of which is likely to be influenced by the manner in which they are accounted for in the financial statements, or in other *subject matter information*.

Whilst it is possible to consider tax services under broad headings, such as tax planning or compliance, in practice these services are often interrelated and it is impracticable to analyse services in this way for the purposes of

attempting to identify generically the threats to which specific tax services give rise. As a result, *firms* need to identify and assess, on a case-by-case basis, the potential threats to the integrity, objectivity and independence of the *firm* and *covered persons* before deciding whether to provide tax services to an entity *relevant to an engagement*.

5.80 The provision of tax services by *firms* to *entities relevant to an engagement* may give rise to a number of threats to the integrity, objectivity and independence of the *firm* and *covered persons*, including the self-interest threat, the management threat, the advocacy threat and, where the work involves a significant degree of subjective judgment and has a material effect on the financial statements, or on other *subject matter information* or *subject matter* of an *engagement*, the self-review threat.

5.81 Where the *firm* provides advice to an *entity relevant to an engagement* on one or more specific matters at the request of the entity, a self-review threat may be created. This self-review threat is more significant where the *firm* undertakes a substantial proportion of the tax planning and compliance work for the entity. However, the *firm* may be able to provide such services, provided that there is *informed management* and appropriate safeguards are applied to reduce the self-review threat to a level where independence is not compromised.

5.82 Examples of such safeguards that may be appropriate when tax services are provided to an *entity relevant to an engagement* include ensuring that:

- the tax services are provided by partners and *staff* who have no involvement in the *engagement*;
- the tax services are reviewed by an independent tax partner, or other senior tax employee;
- external independent advice is obtained on the tax work;
- tax computations prepared by the *engagement team* are reviewed by a partner or senior *staff* member with relevant expertise who is not a member of the *engagement team*; or
- a partner with relevant expertise not involved in the *engagement* reviews whether the tax work has been properly and effectively addressed in the context of the *engagement*.

5.83 **The *firm* shall not promote tax structures or products or provide tax advice to an *entity relevant to an engagement* where the *engagement partner* has, or ought to have, reasonable doubt as to whether the related accounting treatment involved is based on well-established interpretations or is appropriate, having regard to the relevant financial reporting framework, including, where applicable, the requirement for financial statements to give a true and fair view.**

For audits of *public interest entities* the prohibition established in paragraph 5.167R(a)(vii) must also be complied with, subject to the derogation provided for in paragraph 5.168R.

5.84 Where the *firm* promotes tax structures or products or provides tax advice to an *entity relevant to an engagement*, it may be necessary to adopt an accounting treatment that is not based on well-established interpretations or

may not be appropriate, in order to achieve the desired result. A self-review threat arises in the course of an *engagement* because the *firm* may be unable to form an impartial view of the accounting treatment to be adopted for the purposes of the proposed arrangements. Accordingly, this Ethical Standard does not permit the promotion of tax structures or products by *firms* to an *entity relevant to an engagement* where, in the view of the *engagement partner*, after such consultation as is appropriate, there is reasonable doubt as to whether the effectiveness of the tax structure or product depends on an accounting treatment that is well-established and appropriate.

5.85 **The *firm* shall not provide tax services wholly or partly on a *contingent fee basis* to:**

(a) a *listed entity relevant to an engagement* that is not an *SME listed entity* (see paragraph 5.47), or a *significant affiliate* of such an entity; or

(b) or any other *entity relevant to an engagement,* where not otherwise prohibited by paragraph 4.14 of Section 4 of Part B of this Ethical Standard*,* for which the tax outcome in respect of the services (and, therefore, the amount of the fee) is uncertain, dependent on the proposed application of tax law, and may be material to present or future financial statements or other *subject matter information* or *subject matter* of the *engagement*.

For audits of *public interest entities* the prohibitions established in paragraph 5.167R(a) must also be complied with, subject to the derogations provided for in paragraph 5.168R.

5.86 Paragraph 4.14 of Section 4 of Part B of this Ethical Standard establishes conditions that preclude providing *non-audit / additional services* on a *contingent fee basis*.

5.87 Where tax services, such as advising on corporate structures, structuring transactions to achieve a particular effect, or otherwise with an objective of reducing tax charges are undertaken on a *contingent fee basis* for an *entity relevant to an engagement*, self-interest threats to the integrity, objectivity and independence of the *firm* or *covered persons* may arise. The *firm* may have, or may appear to have, an interest in the success of the tax services, causing the *firm* to make a judgment about which there is reasonable doubt as to its appropriateness. For an *entity relevant to an engagement* that is a *listed entity* that is not an SME *listed entity*, or a *significant affiliate* of such an entity, the self-interest threat cannot be eliminated or reduced to a level where independence is not compromised by the application of any safeguards.

5.88 For other *entities relevant to an engagement*, the self-interest threat cannot be eliminated or reduced to a level where independence is not compromised by the application of any safeguards where the outcome in respect of the services (and, therefore, the amount of the contingent fee) is uncertain, dependent on the proposed application of tax law, and where the tax implications are, or may be, material to present or future financial statements or other *subject matter information* or *subject matter* of the *engagement*.

5.89 **The *firm* shall not provide tax services to an *entity relevant to an engagement* other than an *investment circular reporting engagement***

where the service would involve the *firm* undertaking a management role.

For audits of *public interest entities* the prohibition established in paragraph 5.167R(b) must also be complied with.

5.90 **The *firm* shall not provide tax services to an *entity relevant to an investment circular reporting engagement* where the service would involve the *firm* undertaking a management role in relation to the transaction or the financial information that is the subject of the *investment circular reporting engagement*.**

5.91 When providing tax services to an *entity relevant to an engagement*, there is a risk that the *firm* undertakes a management role, unless the *firm* is working with '*informed management*'.

5.92 **Where an *entity relevant to the engagement* is a *listed entity* that is not an *SME listed entity* (see paragraph 5.47), or a *significant affiliate* of such an entity, the *firm* shall not provide a service to prepare current or deferred tax calculations that are or may reasonably be expected to be used by the entity when preparing accounting entries that are material to the financial statements or other *subject matter information* or *subject matter* of the *engagement*.**

For audits of *public interest entities* the prohibition established in paragraph 5.167R(a)(vi) must also be complied with, subject to the derogation provided for in paragraph 5.168R.

5.93 For *listed entities* that are not *SME listed entities,* or *significant affiliates* of such entities, the threats to integrity, objectivity and independence that would be created are too high to allow the *firm* to provide a service to prepare calculations of current or deferred tax liabilities or assets for the purpose of preparing accounting entries that are material to the financial statements or other *subject matter information* or *subject matter* of the *engagement*, together with associated disclosure notes.

5.94 Paragraph 5.92 is not intended to prevent a *firm* preparing tax calculations after the completion of the *engagement* for the purpose of submitting tax returns.

5.95 For entities other than *public interest entities* and other *listed entities* that are not *SME listed entities*, or *significant affiliates* of *listed entities* that are not *SME listed entities*, the *firm* may provide a service to prepare current or deferred tax calculations for the purpose of preparing accounting entries, provided that:

(a) such services:

  (i) do not involve initiating transactions or taking management decisions; and

  (ii) are of a technical, mechanical or an informative nature; and

(b) appropriate safeguards are applied.

5.96 The *firm's* policies and procedures will set out whether there are circumstances in which current or deferred tax calculations for the purpose of preparing accounting entries are not prepared for non-listed entities as described in paragraph 1.49 of Section 1of Part B of this Ethical Standard.

5.97 **The *firm* shall not provide tax services to an *entity relevant to an engagement* where this would involve acting as an advocate for the entity in the resolution of an issue:**

(a) that is material to the entity's present or future financial statements, or the *subject matter information* or *subject matter* of the *engagement*; or

(b) where the outcome of the tax issue is dependent on a future or contemporary judgment by the *firm* in relation to the financial statements, or other *subject matter information* or *subject matter* of the *engagement*.

For audits of *public interest entities* the prohibition established in paragraph 5.167R(a)(v) must also be complied with, subject to the derogation provided for in paragraph 5.168R.

5.98 Supporting ethical provision 2.3D, which embodies legal requirements for *statutory audits*, requires, inter alia, that a *firm* does not accept, continue or carry out an *engagement* if there is any threat of advocacy which would compromise the independence of the *firm* or *covered persons*. Where the tax services to be provided by the *firm* include representing the entity in any negotiations or proceedings involving the tax authorities, advocacy threats to the integrity, objectivity and independence of the *firm* and *covered persons* may arise.

5.99 The meaning of an 'advocacy threat' is described in paragraph 1.29 of Section 1 of Part B of this Ethical Standard. It includes supporting a position taken by management in an adversarial context, where the *firm* has to adopt a position closely aligned to that of management.

5.100 The *firm* is not acting as an advocate where the tax services involve the provision of information to the tax authorities (including an explanation of the approach being taken and the arguments being advanced by the entity). In such circumstances effective safeguards may exist and the tax authorities will undertake their own review of the issues.

5.101 Where the *firm* has been providing assistance in dealing with tax authorities and those tax authorities indicate that they are minded to reject the entity's arguments on a particular issue and the matter is likely to be determined by an appeals tribunal or court, the *firm* may become so closely identified with management's arguments that the *firm* is inhibited from forming an impartial view of the treatment of the issue in the financial statements, or in other *subject matter information* or *subject matter* of the *engagement* in the case of an other *public interest assurance engagement*. In such circumstances, if the issue is material to the financial statements, or other *subject matter information* or *subject matter* of the *engagement*, or is dependent on a future or contemporary judgment by the *firm* in relation to the *engagement*, the advocacy threat will be such that no safeguards can reduce it to a level where independence is not compromised. Accordingly, in such circumstances, the

firm discusses the matter with the entity and makes it clear that it will have to withdraw from providing tax services that require it to act as advocate for the entity, or resign from the *engagement* from the time when the matter is formally listed for hearing before the appeals tribunal.

5.102 If the *firm* withdraws from providing tax services for the reasons described in paragraph 5.101, the *firm* is not precluded from having a continuing role (for example, responding to specific requests for information) for the entity in relation to the appeal, providing that the continuing role does not give rise to an advocacy threat that would compromise the independence of the *firm* or *covered persons*. The *firm* also assesses the threat associated with any continuing role in accordance with paragraphs 5.103 to 5.105 of this Section.

Litigation Support Services

5.103 Although management and advocacy threats may arise in litigation support services, such as acting as an expert witness, the primary issue is that a self-review threat will arise in all cases where such services involve a subjective estimation of the likely outcome of a matter that is material to the amounts to be included or the disclosures to be made in the financial statements.

5.104 **The *firm* shall not provide litigation support services to:**

(a) a *listed entity relevant to an engagement* that is not an *SME listed entity* (see paragraph 5.47), or a *significant affiliate* of such an entity, where this would involve the estimation by the *firm* of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the *listed entity's* financial statements, or in other *subject matter information* or *subject matter* of the *engagement*, either separately or in aggregate with other estimates and valuations provided; or

(b) any other *entity relevant to an engagement*, where this would involve the estimation by the *firm* of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the entity's financial statements, or in other *subject matter information* or *subject matter* of the *engagement*, either separately or in aggregate with other estimates and valuations provided and there is a significant degree of subjectivity involved.

For audits of *public interest entities* the prohibition established in paragraph 5.167R(f) must also be complied with, subject to the derogation provided for in paragraph 5.168R.

5.105 In the case of non-listed entities, litigation support services that do not involve such subjective estimations are not prohibited, provided that the *firm* has carefully considered the implications of any threats and established safeguards to reduce those threats to a level where independence is not compromised.

5.106 The *firm*'s policies and procedures will set out whether there are circumstances in which litigation support services are not undertaken for non-listed entities as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

Legal Services

5.107 **The *firm* shall not provide legal services to an *entity relevant to an engagement*, where this would involve acting as the solicitor formally nominated to represent the entity in the resolution of a dispute or litigation which is material to the amounts to be included or the disclosures to be made in the financial statements, or in other *subject matter information* or *subject matter* of the *engagement*.**

> For audits of *public interest entities* the prohibition established in paragraph 5.167R(g) must also be complied with.

5.108 Although the provision by the *firm* of certain types of legal services to an *entity relevant to an engagement* may create advocacy, self-review and management threats, this Ethical Standard does not impose a general prohibition on the provision of legal services. However, in view of the degree of advocacy involved in litigation or other types of dispute resolution procedures and the potential importance of any assessment by the *firm* of the merits of the entity's position when undertaking an *engagement*, this Ethical Standard prohibits a *firm* from acting as the formally nominated representative for an *entity relevant to an engagement* in the resolution of a dispute or litigation which is material to the amounts recognised or disclosed the financial statements or other *subject matter information* or *subject matter* of the *engagement*.

Recruitment and Remuneration Services

5.109 **The *firm* shall not provide recruitment services to an *entity relevant to an engagement*, that would involve the *firm* taking responsibility for the appointment of any director or:**

(a) where the *firm* is undertaking an *engagement* other than an *investment circular reporting engagement*, any employee of the entity; or

(b) where the *firm* is undertaking an *investment circular reporting engagement*, any employee of the entity who will be involved in an area that is directly concerned with the transaction which is the subject of the *investment circular*.

> For audits of *public interest entities* the prohibitions established in paragraphs 5.167R(b) and(k) must also be complied with.

5.110 A management threat arises where *firm* personnel take responsibility for any decision as to who is appointed by the entity.

5.111 **For a *listed entity,* that is not an *SME listed entity* (see paragraph 5.47), *relevant to an engagement*, the *firm* shall not provide recruitment services in relation to a *key management position* of the entity, or a *significant affiliate* of such an entity.**

> For audits of *public interest entities* the prohibition established in paragraph 5.167R(k) must also be complied with.

5.112 A familiarity threat arises if the *firm* plays a significant role in relation to the identification and recruitment of senior members of management within the entity, as the *engagement team* may be less likely to be critical of the information or explanations provided by such individuals than might otherwise be the case. Accordingly, for a *listed entity relevant to an engagement*, other than an *investment circular reporting engagement*, that is not an *SME listed entity*, and for *significant affiliates* of such entities, the *firm* does not provide services that involve the recruitment of individuals for *key management positions*.

5.113 The *firm's* policies and procedures will set out whether there are circumstances in which recruitment services are not undertaken for non-listed entities as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

5.114 Where the *firm* providing an *investment circular reporting engagement* has played a significant role in relation to the identification and recruitment of a senior member of management within the entity, including all directors, prior to the '*relevant period*', the *engagement partner* considers whether a familiarity threat exists, taking account of factors such as:

- the closeness of personal relationships between the *firm's* partners, *staff* and other *covered persons*, and the entity's personnel;
- the length of time since the recruitment of the individual in question;
- the position held by the individual at the entity;
- the extent of involvement that the individual will have with the transaction that is the subject of the *investment circular*;
- whether the individual is in a position to exercise influence on the accounting records or financial information.

Following the assessment of any such threats, appropriate safeguards are applied where necessary, such as ensuring that the *engagement team* does not include individuals with a close relationship to the senior member of management or who were involved in the recruitment exercise.

5.115 Recruitment services involve a specifically identifiable, and separately remunerated, engagement. *Firms* and *engagement teams* may contribute to an entity's recruitment process in less formal ways. The prohibitions set out in paragraphs 5.109 and 5.111 do not extend to:

- senior members of an *engagement team* interviewing prospective directors or employees of the entity and advising on the candidate's technical financial competence; or
- the entity using information gathered by the *firm*, including that relating to salary surveys.

5.116 **The *firm* shall not provide advice on the quantum of the remuneration package or the measurement criteria on which the quantum is calculated, for a director or *key management position* of an *entity relevant to an engagement*.**

For audits of *public interest entities* the prohibition established in paragraph 5.167R(k) must also be complied with.

5.117 The provision of advice on remuneration packages (including bonus arrangements, incentive plans and other benefits) to existing or prospective employees of the entity gives rise to familiarity threats. The significance of the familiarity threat is considered too high to allow advice on the overall amounts to be paid or on the quantitative measurement criteria included in remuneration packages for directors and *key management positions*.

5.118 For other employees, these threats can be adequately addressed by the application of safeguards, such as the advice being provided by partners and *staff* who have no involvement in the *engagement*.

5.119 In cases where all significant judgments concerning the assumptions, methodology and data for the calculation of remuneration packages for directors and key management are made by '*informed management*' or a third party and the *firm's* role is limited to applying proven methodologies using the given data, for which the management takes responsibility, it may be possible to establish effective safeguards to protect the integrity, objectivity and independence of the *firm* and *covered persons*.

5.120 Advice on tax, pensions and interpretation of accounting standards relating to remuneration packages for directors and key management can be provided by the *firm*, provided they are not prohibited by the requirements of this Ethical Standard relating to tax, actuarial valuations and *accounting services*. Disclosure of the provision of any such advice would be made to those charged with governance of the entity (see Section 1 of this Ethical Standard, paragraphs 1.61 to 1.71 of Section 1 of part B of this Ethical Standard).

Corporate Finance Services

5.121 The range of services encompassed by the term 'corporate finance services' is wide. For example, the *firm* may undertake:

- to identify possible purchasers for parts of the entity's business and provide advisory services in the course of such sales; or
- to identify possible 'targets' for the entity to acquire; or
- to advise the entity on how to fund its financing requirements; or
- to act as sponsor on admission to listing on the London Stock Exchange, or as Nominated Advisor on the admission of the entity on the Alternative Investments Market (AIM); or
- to act as financial adviser to entity offerors or offerees in connection with public takeovers.

5.122 The potential for the integrity, objectivity and independence of the *firm* and *covered persons* to be compromised through the provision of corporate finance services varies considerably depending on the precise nature of the service provided. The main threats to integrity, objectivity and independence arising from the provision of corporate finance services are the self-review, management and advocacy threats. Self-interest threats may also arise, especially in situations where the *firm* is paid on a *contingent fee basis*.

5.123 When providing corporate finance services to an *entity relevant to an engagement*, there is a risk that the *firm* undertakes a management role,

unless the *firm* is working with '*informed management*'. In addition, appropriate safeguards are applied to reduce any self-review threat to a level where independence is not compromised.

5.124 Examples of safeguards that may be appropriate when corporate finance services are provided to an *entity relevant to an engagement*, include ensuring that:

- the corporate finance advice is provided by partners and *staff* who have no involvement in the *engagement*;
- any advice provided is reviewed by an independent corporate finance partner within the *firm*;
- external independent advice on the corporate finance work is obtained;
- a partner who is not involved in the *engagement* reviews the *engagement* work performed in relation to the *subject matter* of the corporate finance services provided to ensure that such *engagement* work has been properly and effectively reviewed and assessed in the context of the *engagement*.

5.125 Where the *firm* provides corporate finance services to an *entity relevant to an engagement* in connection with conducting the sale or purchase of a material part of the entity's business, the *engagement partner* informs the audit committee (or equivalent) and, where applicable, any other person or entity the *firm* is instructed to advise, about the corporate finance service, as set out in paragraphs 1.61 to 1.71 of Section 1 of Part B of this Ethical Standard.

5.126 **The *firm* shall not provide corporate finance services in respect of an *entity relevant to an engagement*, where:**

(a) the service would involve the *firm* taking responsibility for dealing in, underwriting, or promoting shares; or

(b) the *engagement partner* has, or ought to have, reasonable doubt as to whether an accounting treatment that is subject to a contemporary or future judgment by the *firm* relating to a material matter in the financial statements or in other *subject matter information* or *subject matter* of the *engagement*, and upon which the success of the related transaction depends:

(i) is based on well-established interpretations; or

(ii) is appropriate;

having regard to the requirements of the relevant reporting framework, including where applicable for financial statements to give a true and fair view; or

(c) the *firm* is undertaking an *engagement* other than an *investment circular reporting engagement*, and the service would involve undertaking a management role in the entity; or

(d) the *firm* is undertaking an *investment circular reporting engagement*, and the service would involve undertaking a management role in the entity in relation to the transaction or the *subject matter information* or *subject matter* of the *investment circular reporting engagement*.

For audits of *public interest entities* the prohibitions established in paragraphs 5.167R(b), (i) and (j) must also be complied with.

5.127 An unacceptable advocacy threat arises where, in the course of providing a corporate finance service, the *firm* promotes the interests of the entity by taking responsibility for dealing in, underwriting, or promoting shares.

5.128 Where the *firm* acts as a sponsor under the Listing Rules[57], or as Nominated Adviser on the admission of the entity to AIM, the *firm* is required to confirm that the entity has satisfied all applicable conditions for listing and other relevant requirements of the listing (or AIM) rules. Where there is, or there ought to be, reasonable doubt that the *firm* will be able to give that confirmation, it does not enter into providing such service.

5.129 A self-review threat arises where the outcome or consequences of the corporate finance service provided by the *firm* may be material to the financial statements or other *subject matter information* or *subject matter*, which are, or will be, subject to an *engagement* by the same *firm*. Where the *firm* provides corporate finance services, for example advice to the entity on financing arrangements, it may be necessary to adopt an accounting treatment that is not based on well-established interpretations or which may not be appropriate, in order to achieve the desired result. A self-review threat is created because the *firm* may be unable to form an impartial view of the accounting treatment to be adopted for the purposes of the proposed arrangements. Accordingly, this Ethical Standard does not permit the provision of such services by *firms* in respect of an *entity relevant to an engagement* by them where there is or ought to be reasonable doubt as to whether an accounting treatment that is subject to a contemporary or future judgment by the *firm* relating to a material matter in the financial statements, or in other *subject matter information* or *subject matter*, of the entity and on which the success of a transaction depends is well-established and appropriate.

5.130 Advice to entities on funding issues and banking arrangements, where there is no reasonable doubt as to the appropriateness of the accounting treatment, is not prohibited provided this does not involve the *firm* in taking decisions or making judgments which are properly the responsibility of management.

5.131 These restrictions do not apply in circumstances where the *firm* is designated by legislation or regulation as being required to carry out a particular service. In such circumstances, the *engagement partner* establishes appropriate safeguards.

Transaction Related Services

5.132 In addition to corporate finance services, there are other services associated with transactions that a *firm* may undertake for an *entity relevant to an engagement*. For example:

- investigations into possible acquisitions or disposals ('due diligence' investigations); or

[57] The UK Listing Authority's publication the 'Listing Rules'.

- investigations into the tax affairs of possible acquisitions or disposals; or
- the provision of information to management or sponsors in relation to prospectuses and other *investment circulars* (for example, long form reports, comfort letters on the adequacy of working capital); or
- agreed-upon procedures or reports provided to management in relation to particular transactions (for example, securitisations).

5.133 When providing transaction related services to an *entity relevant to an engagement*, there is a risk that the *firm* may face a management threat, unless the *firm* is working with *informed management*. In addition, appropriate safeguards are applied to reduce any self-review threat to a level where independence is not compromised.

5.134 Examples of safeguards that may be appropriate when threats are identified in relation to transaction related services provided to an *entity relevant to an engagement* include ensuring that:

- the transaction related advice is provided by partners and *staff* who have no involvement in the *engagement*;
- any advice provided is reviewed by an independent transactions partner within the *firm*;
- external independent advice on the transaction related work is obtained;
- a partner with relevant expertise who is not involved in the *engagement* reviews the *engagement* work performed in relation to the *subject matter* of the transaction related service provided to ensure that such work has been properly and effectively reviewed and assessed in the context of the *engagement*.

5.135 **The *firm* shall not provide transaction related services in respect of an *entity relevant to an engagement*, where:**

(a) the *engagement partner* has, or ought to have, reasonable doubt as to whether an accounting treatment that is subject to a contemporary or future judgment by the *firm* relating to a material matter in the financial statements, or other *subject matter information* or *subject matter* of the *engagement*, and upon which the success of the related transaction depends;

(i) is based on well-established interpretations; or

(ii) is appropriate;

having regard to the requirements of the relevant reporting framework, including where applicable for financial statements to give a true and fair view; or

(b) the *firm* is undertaking an *engagement* other than an *investment circular reporting engagement*, and the service would involve undertaking a management role in the entity; or

(c) the *firm* is undertaking an *investment circular reporting engagement*, and the service would involve undertaking a management role in the entity in relation to the transaction or the *subject matter information* or *subject matter* of the *investment circular reporting engagement*.

For audits of *public interest entities* the prohibition established in paragraphs 5.167R(b) and (i) must also be complied with.

5.136 A self-review threat arises where the outcome of the transaction related services undertaken by the *firm* may be material to the financial statements or other *subject matter information* or *subject matter* of the entity which are, or will be, subject to an *engagement* by the same *firm*. Where the entity proposes to undertake a transaction, it may be necessary to adopt an accounting treatment that is not based on well-established interpretations or may not be appropriate, in order to achieve the desired result of the transaction (for example, to take assets off the balance sheet). A self-review threat is created if the *firm* undertakes transaction related services in connection with such a transaction. Accordingly, this Ethical Standard does not permit the provision of services by *firms* in respect of an *entity relevant to an engagement* by them where there is or ought to be reasonable doubt as to whether an accounting treatment, that is subject to a contemporary or future judgment by the *firm* relating to a material matter in the financial statements, or in other *subject matter information* or *subject matter* of the entity and on which the success of a related transaction depends, is well-established and appropriate.

5.137 These restrictions do not apply in circumstances where the *firm* is designated by legislation or regulation as being required to carry out a particular service. In such circumstances, the *engagement partner* establishes appropriate safeguards.

Restructuring Services

5.138 Restructuring services are any *non-audit services* provided to an entity in connection with the entity's development or implementation of a transaction or package of transactions (a 'restructuring plan') designed to change its equity or debt financing structure, its corporate structure, or its operating structure. There are a variety of possible purposes for developing a restructuring plan, for example to address financial or operating difficulties, to support tax planning, to improve operating efficiency, or to improve the cost of capital. The range of *non-audit / additional services* that may be regarded as 'Restructuring Services' is extensive, and the nature of those services may encompass many of the other types of *non-audit / additional services* discussed in this Ethical Standard. Where applicable, the related requirements and guidance covered elsewhere in this Ethical Standard apply to Restructuring Services.

5.139 The restructuring services that an entity may use a *firm* to provide may vary considerably and may range from the incidental and routine to advice that is fundamental to the efficacy of the restructuring plan. Consequently, where such services are provided by a *firm* that that provides an *engagement* for the entity, the *engagement partner*:

- the threats that the restructuring services may present to the *firm's* ability to conduct any contemporary or future *engagement* with integrity, objectivity and independence; and
- the probability that an objective, reasonable and informed third party would conclude that the independence of the *firm* or *covered persons*

would be compromised.

5.140 **The *firm* shall not provide restructuring services in respect of an *entity relevant to an engagement*, where:**

(a) the service would involve the firm undertaking a management role in or on behalf of the entity; or

(b) the service would require the *firm* to act as an advocate for the entity in relation to matters that are material to the financial statements, or other *subject matter information* or *subject matter* of the *engagement*.

For audits of *public interest entities* the prohibition established in paragraphs 5.167R(b) and (i) must also be complied with.

5.141 The potential for the integrity, objectivity and independence of the *firm* or *covered persons* to be compromised through the provision of restructuring services varies depending on the nature of the service provided. Two of the main threats to integrity, objectivity and independence arising from the provision of restructuring services arise where the *firm* undertakes a management or advocacy role:

- A *firm* undertakes a management role if the entity does not have '*informed management*' capable of taking responsibility for the decisions to be made.
- To avoid undertaking an advocacy role on behalf of the entity, the *firm* takes particular care not to assume (or seen to be assuming) responsibility for the entity's proposals or being regarded as negotiating on behalf of the entity or advocating the appropriateness of the proposals such that its independence would be compromised. This is particularly important when the *firm* attends meetings with the entity's bank or other interested parties.

If the *firm* undertakes a management role or acts as advocate for the entity, the threats to integrity, objectivity and independence of the *firm* and *covered persons* are such that no safeguards can reduce the threat to a level where independence is not compromised[58].

5.142 **The *firm* shall not provide restructuring services in respect of an *entity relevant to engagement*, where that service may give rise to a self-review threat in the course of a contemporary or future *engagement* unless it is satisfied that such threats can be reduced by appropriate safeguards to a level where independence is not compromised and that such safeguards have been put in place.**

For audits of *public interest entities* the prohibition established in paragraph 5.167R(i) must also be complied with.

5.143 The provision of restructuring services gives rise to a self-review threat where the restructuring services to be provided involve advice or judgments which

[58] 'ES – Provisions Available for Small Entities (Revised)' provides exemptions relating to *informed management* and the advocacy threat for auditors of small entities.

are likely to be material to a contemporary or future judgment of the *firm* in relation to an *engagement*.

5.144 Examples of restructuring services that the *firm* may be requested to undertake and which may give rise to a self-review threat include:

- Providing preliminary general advice on the options and choices available to management or stakeholders of an entity facing urgent financial or other difficulties.
- Undertaking a review of the business of the entity with a view to advising the entity on liquidity management or operational restructuring options.
- Advising on the development of forecasts or projections, for presentation to lenders and other stakeholders, including assumptions.
- Advising the entity on how to fund its financing requirements, including equity and debt restructuring programmes.
- Participating in the design or implementation of an overall restructuring plan including, for example, participating in the preparation of cash flow and other forecasts and financial models underpinning the overall restructuring plan.

5.145 The self-review threat arising from the provision of such services is particularly significant where, in relation to an *audit engagement*, it has potential to impact the *firm's* assessment of whether it is appropriate to prepare the entity's financial statements on a going concern basis. Where the *firm* has been involved in aspects of the preparation of a cash flow, a forecast or a financial model, it is probable that an objective, reasonable and informed third party would conclude that the *firm* would have a significant self-review threat in considering the going concern assumption.

5.146 The self-review threat arising from the provision of such services is also particularly significant where the restructuring services are provided in respect of an *audited entity* and involve developing or implementing a restructuring plan to address the actual or anticipated financial or operational difficulties that threaten the survival of that entity as a going concern (an *'audited entity in distress*').

5.147 The *firm* puts in place those safeguards that it regards as appropriate to reduce the threats to the integrity and objectivity of the *firm* and *covered persons* to a level where independence is not compromised. If the *firm* concludes that the threats arising from some or all of the restructuring services involved cannot be addressed by putting appropriate safeguards in place, it declines providing the service, or those parts of the service affected by those threats that cannot be adequately addressed.

5.148 **Where an *entity in distress relevant to an engagement*, is a *listed entity* that is not an *SME listed entity* (see paragraph 5.47), or a *significant affiliate* of such a *listed entity*, the restructuring services provided by the *firm* shall be limited to providing:**

(a) preliminary general advice to an *entity in distress*;

(b) assistance with the implementation of elements of an overall restructuring plan, such as the sale of a non-significant

component business, provided those elements are not material to the overall restructuring plan;

(c) challenging, but in no circumstances developing, the projections and assumptions within a financial model that has been produced by the *entity in distress*;

(d) reporting on a restructuring plan, or aspects of it, in connection with the proposed issue of an *investment circular*; and

(e) where specifically permitted by a regulatory body with oversight of the *entity in distress*.

For audits of *public interest entities* the prohibition established in paragraph 5.167R(i) must also be complied with.

5.149 Except to the extent identified in paragraph 5.148, the significance of the self-review threat is too high to permit the provision of other restructuring services to an *entity in distress* that is a *listed entity* that is not an *SME listed entity*, or a *significant affiliate* of such a *listed entity,* because there are no safeguards that would be sufficient to reduce the resultant threats to a level where independence is not compromised.

5.150 The *firm's* policies and procedures will set out whether there are circumstances in which restructuring services are not undertaken for non-listed entities in distress as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

Accounting Services

5.151 For the purpose of this Ethical Standard, the term '*accounting services*' is defined as the provision of services that involve the maintenance of accounting records or the preparation of financial statements or other *subject matter information* or *subject matter* that are then subject to audit or an other *public interest assurance engagement*. Advice on the implementation of current and proposed accounting standards is not included in the term *accounting services*.

5.152 The range of activities encompassed by the term *accounting services* is wide. In some cases, the entity may ask the *firm* to provide a complete accounting service including maintaining all of the accounting records and the preparation of the financial statements. Other common situations are:

- the *firm* may take over the provision of a specific accounting function on an outsourced basis (for example, payroll);
- the entity maintains the accounting records, undertakes basic bookkeeping and prepares a year-end trial balance and asks the *firm* to assist with the preparation of the necessary adjustments and the financial statements.

5.153 The provision of *accounting services* by the *firm* to an *entity relevant to an engagement* creates threats to the integrity, objectivity and independence of the *firm* and *covered persons*, principally self-review and management threats, the significance of which depends on the nature and extent of the *accounting services* in question and upon the level of public interest in the entity.

5.154 When providing *accounting services* to an entity relevant to an audit or other *public interest assurance engagement* by the *firm*, unless the *firm* is working with *informed management*, there is a risk that the *firm* undertakes a management role.

5.155 **The *firm* shall not provide *accounting services* to an *entity relevant to an engagement* other than an *investment circular reporting engagement* where:**

(a) the entity is a *listed entity* that is not an *SME listed entity* (see paragraph 5.47), *relevant to an engagement* by the *firm*, or a *significant affiliate* of such an entity; or

(b) for any other entity:

- **those *accounting services* would involve the *firm* undertaking part of the role of management; or**
- **the financial information is the subject of an *investment circular reporting engagement*.**

For audits of *public interest entities* the prohibitions established in paragraphs 5.167R(a)(i)-(a)(iii), (b), (c) and (d) must also be complied with, subject to the derogation provided for in paragraph 5.168R regarding 5.167R(a)(i).

5.156 **The *firm* shall not provide *accounting services* in relation to the financial information that is the subject of an *investment circular reporting engagement* by the *firm*.**

5.157 Even where there is no undertaking to provide any *accounting services*, it is usual for the *firm* to provide the management with accounting advice on matters that have come to its attention during the course of an *engagement*. Such matters might typically include:

- comments on weaknesses in the accounting records and suggestions for addressing them;
- errors identified in the accounting records and in the financial statements, or other *subject matter information* or *subject matter*, and suggestions for correcting them;
- advice on the accounting policies in use and on the application of current and proposed accounting standards.

This advice is a by-product of the *engagement* rather than the result of any undertaking to provide *non-audit / additional services*. Consequently, as it is part of the *engagement*, such advice is not regarded as giving rise to any threat to the integrity, objectivity and independence of the *firm* and *covered persons*.

5.158 For *listed entities* that are not *SME listed entities relevant to an engagement* other than an *investment circular reporting engagement*, or *significant affiliates* of such entities, the threats to integrity, objectivity and independence that would be created are too high to allow the *firm* to provide any *accounting services*.

5.159 The threats to the *reporting accountant's* integrity, objectivity and independence that would be created are too high to allow the *firm* to provide any *accounting services* in relation to the financial information that is the subject of an *investment circular reporting engagement* by the *firm*.

5.160 The *firm's* policies and procedures will set out whether there are circumstances in which *accounting services* are not undertaken for non-listed entities as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

5.161 For entities other than *listed entities* that are not *SME listed entities* relevant to an *engagement* other than an *investment circular reporting engagement*, or *significant affiliates* of such *listed entities*, the *firm* may provide *accounting services*, provided that:

(a) such services:

(i) do not involve initiating transactions or taking management decisions; and

(ii) are of a technical, mechanical or an informative nature; and

(b) appropriate safeguards are applied to reduce the self-review threat to a level where independence is not compromised.

5.162 The maintenance of the accounting records and the preparation of the financial statements are the responsibility of the management of the entity. Accordingly, in any undertaking to provide the entity with *accounting services*, the *firm* does not initiate any transactions or take any decisions or make any judgments, which are properly the responsibility of the management. These include:

- authorising or approving transactions;
- preparing originating data (including valuation assumptions);
- determining or changing journal entries, or the classifications for accounts or transactions, or other accounting records without management approval.

5.163 Examples of *accounting services* of a technical or mechanical nature or of an informative nature include:

- recording transactions for which management has determined the appropriate account classification, posting coded transactions to the general ledger, posting entries approved by management to the trial balance or providing certain data-processing services (for example, payroll);
- assistance with the preparation of the financial statements where management takes all decisions on issues requiring the exercise of judgment and has prepared the underlying accounting records.

5.164 Examples of safeguards that may be appropriate when *accounting services* are provided to an *entity relevant to an engagement*, include:

- *accounting services* provided by the *firm* are performed by partners and staff who have no involvement in the *engagement*;

- the *accounting services* are reviewed by a partner or other senior *staff* member with relevant expertise who is not a member of the *engagement team*;
- the *engagement* is reviewed by a partner with relevant expertise who is not involved in the *engagement* to ensure that the *accounting services* performed have been properly and effectively assessed in the context of the *engagement*.

Prohibited Non-audit Services for Public Interest Entities

5.165 The requirements in paragraph 5.167R below set out prohibited *non-audit services* for *public interest entities*, as established in the EU Audit Regulation. These prohibitions are applied more widely than the EU where necessary to achieve the ethical outcome of independence, having regard to supporting ethical provision 2.4. Where the work of a *network firm* is used in the conduct of an *engagement*, supporting ethical provision 2.4 stipulates that the ethical requirements that are relevant to the *engagement* are:

> "(b) In the case of a *network firm* whose work is used in the conduct of an *engagemen*t where any *entity relevant to the engagement* is a *public interest entity*, this Ethical Standard."

Accordingly, such *network firms,* whether or not within the Union, are also subject to the prohibitions in paragraph 5.167R for an *audit engagement* where any *entity relevant to the engagement* is a *public interest entity*.

5.166 The *audit firm's* policies and procedures will set out whether there are circumstances in which the services specified in paragraph 5.167R are undertaken for entities that are not *public interest entities* as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

5.167R ~~**A statutory auditor or**~~ **An *audit firm* carrying out the *statutory audit* of a *public interest entity*, or any member of the network to which the ~~statutory auditor or the~~ *audit firm* belongs, shall not directly or indirectly provide to the *audited entity*, to its parent undertaking or to its controlled undertakings within the Union any prohibited non-audit services in:**

(a) the period between the beginning of the period audited and the issuing of the audit report; and

(b) the financial year immediately preceding the period referred to in point (a) in relation to the services listed in point (e) of the second subparagraph.

For these purposes ~~of this Article~~, prohibited non-audit services shall mean:

(a) tax services relating to:

(i) preparation of tax forms;

(ii) payroll tax;

(iii) customs duties;

(iv) identification of public subsidies and tax incentives unless support from the ~~statutory auditor or the~~ *audit firm* in respect of such services is required by law;

(v) support regarding tax inspections by tax authorities unless support from the ~~statutory auditor or the~~ *audit firm* in respect of such inspections is required by law;

(vi) calculation of direct and indirect tax and deferred tax;

(vii) provision of tax advice;

(b) services that involve playing any part in the management or decision-making of the *audited entity*;

(c) bookkeeping and preparing accounting records and financial statements;

(d) payroll services;

(e) designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems;

(f) valuation services, including valuations performed in connection with actuarial services or litigation support services;

(g) legal services, with respect to:

(i) the provision of general counsel;

(ii) negotiating on behalf of the *audited entity*; and

(iii) acting in an advocacy role in the resolution of litigation;

(h) services related to the *audited entity's* internal audit function;

(i) services linked to the financing, capital structure and allocation, and investment strategy of the *audited entity*, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the *audited entity*;

(j) promoting, dealing in, or underwriting shares in the *audited entity*;

(k) human resources services, with respect to:

(i) management in a position to exert significant influence over the preparation of the accounting records or financial statements which are the subject of the *statutory audit*, where such services involve:

— **searching for or seeking out candidates for such position; or**

— **undertaking reference checks of candidates for such positions;**

(ii) structuring the organisation design; and

(iii) cost control. [AR 5.1]

5.168R **By way of derogation from the second subparagraph of paragraph ~~1~~ 5.167R, the services referred to in points (a)(i), (a)(iv) to (a)(vii) and (f), may be provided if the following requirements are complied with:**

(a) they have no direct or, in the view of an objective, reasonable and informed third party, would have ~~immaterial~~ an inconsequential effect, separately or in the aggregate on the audited financial statements;

(b) the estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee ~~referred to in Article 11; and~~

(c) the principles of independence laid down in Section 1 of this Ethical Standard ~~the EU Audit Directive 2006/43/EC~~ are complied with ~~by the statutory auditor or the audit *firm*~~; and [AR 5.3]

(d) for the purposes of the *statutory audit* of the financial statements, the *audit firm* would not place significant reliance on the work performed by the *audit firm* in performing these services.

5.169 Where there are doubts about whether a service would have an inconsequential effect on the audited financial statements in the view of and objective, reasonable and informed third party, then the effect is not regarded as inconsequential.

5.170R ~~A statutory auditor or~~ An *audit firm* carrying out *statutory audits* of *public interest entities* and, where ~~the statutory auditor or~~ the *audit firm* belongs to a network, any member of such network, may provide to the *audited entity*, to its parent undertaking or to its controlled undertakings non-audit services other than the prohibited non-audit services referred to in paragraph~~s 1 and 2~~ 5.167R subject to the approval of the audit committee after it has properly assessed threats to independence and the safeguards applied in accordance with this Ethical Standard ~~Article 22b of the EU Audit Directive 2006/43/EC~~. The Audit Regulation requires that the audit committee shall, where applicable, issue guidelines with regard to the services referred to in paragraph ~~3~~ 5.168R. [AR 5.4]

5.171R **When a member of a network to which ~~the statutory auditor or~~ the *audit firm* carrying out a *statutory audit* of a *public interest entity* belongs provides any of the non-audit services, referred to in paragraph~~s 1 and 2~~ 5.167R ~~of this Article~~, to an undertaking incorporated in a third country which is controlled by the audited *public interest entity*, ~~the statutory auditor or~~ the *audit firm* concerned shall assess whether ~~his, her or~~ its**

independence would be compromised by such provision of services by the member of the network. [AR 5.5]

5.172R **If ~~his, her or~~ its independence is affected, ~~the statutory auditor or~~ the *audit firm* shall apply safeguards where applicable in order to mitigate the threats caused by such provision of services in a third country.~~The statutory auditor or~~ The *audit firm* may continue to carry out the *statutory audit* of the *public interest entity* only if ~~he, she or~~ it can justify, in accordance with Article 6 of ~~this~~ the EU Audit Regulation and Article 22b[59] of the EU Audit Directive ~~2006/43/EC~~, that such provision of services does not affect ~~his, her or~~ its professional judgment and the audit report. [**AR 5.5]

5.173R **For the purposes of ~~this paragraph~~ the requirements in paragraph 5.171R and 5.172R:**

(a) being involved in the decision-taking of the *audited entity* and the provision of the services referred to in points (b), (c) and (e) of the second subparagraph of paragraph ~~1~~ 5.167R shall be deemed to affect such independence in all cases and to be incapable of mitigation by any safeguards.

(b) provision of the services referred to in the second subparagraph of paragraph ~~1~~ 5.167R other than points (b), (c) and (e) thereof shall be deemed to affect such independence and therefore to require safeguards to mitigate the threats caused thereby. [AR 5.5]

[59] See paragraph 1.74D of Section 1 of Part B of this Ethical Standard.

Section 6 – Provisions Available for Audits of Small Entities

Introduction

This Section does not apply for the audit of '*public interest entities*'.

6.1 This Ethical Standard sets out the overarching principles, supporting ethical provisions and specific requirements, that auditors are required to comply with in order to discharge their responsibilities in respect of their integrity, objectivity and independence. It addresses such matters as:

- How *audit firms* set policies and procedures to ensure that, in relation to each audit, the *audit firm* and all those who are *covered persons* act with integrity, objectivity and independence;
- Financial, business, employment and personal relationships;
- Long association with the *audit engagement*;
- Fees, remuneration and evaluation policies, litigation, gifts and hospitality;
- *Non-audit services* provided to audited entities.

This Ethical Standard applies to all *audit firms* and to all audits and must be read in order to understand the alternative provisions and exemptions contained in this Section of it.

6.2 The FRC is aware that a limited number of the requirements in Sections 1 to 5 of the Ethical Standard are difficult for certain *audit firms* to comply with, particularly when auditing a small entity. Whilst the FRC is clear that Sections 1 to 5 are appropriate in the interests of establishing the integrity, objectivity and independence of auditors, it accepts that certain dispensations, as set out in this Section, are appropriate to facilitate the cost effective audit of the financial statements of Small Entities (as defined below) that are not '*public interest entities*'.

6.3 This Section provides alternative provisions for auditors of Small Entities, that are not '*public interest entities*', to apply in respect of the threats arising from economic dependence and where tax or *accounting services* are provided and allows the option of taking advantage of exemptions from certain of the requirements in Sections 1 to 5 for a Small Entity *audit engagement*. Where an *audit firm* takes advantage of the exemptions within this Section, it is required to:

(a) take the steps described in this Section; and

(b) disclose in the audit report the fact that the *firm* has applied the FRC's Ethical Standard – Provisions Available for Audits of Small Entities.

6.4 In this Standard, for the UK a 'Small Entity' is:

(a) any company, which is not a UK listed company or an *affiliate* thereof, that qualifies as a small company under Section 382 of the Companies Act 2006;

(b) where group accounts are produced, any group that qualifies as small under Section 383 of the Companies Act 2006;

(c) any charity with an income of less than the turnover threshold applicable to small companies as identified in Section 382 of the Companies Act 2006;

(d) any pension fund with less than 100 members (including active, deferred and pensioner members)[60];

(e) any *firm* regulated by the FCA, which is not required to appoint an auditor in accordance with rule SUP 3.3.2R of the FCA Handbook;

(f) any credit union which is a mutually owned financial co-operative established under the Credit Unions Act 1979 and the Industrial and Provident Societies Act 1965 (or equivalent legislation), which meets the criteria set out in (a) above;

(g) any entity registered under the Industrial and Provident Societies Act 1965, incorporated under the Friendly Societies Act 1992 or registered under the Friendly Societies Act 1974 (or equivalent legislation), which meets the criteria set out in (a) above;

(h) any registered social landlord with less than 250 units; and

(i) any other entity, such as a club, which would be a Small Entity if it were a company.

Where an entity falls into more than one of the above categories, it is only regarded as a 'Small Entity' if it meets the criteria of all relevant categories.

Alternative Provisions

Economic Dependence

6.5 **When auditing the financial statements of a Small Entity, an *audit firm* is not required to comply with the requirement in paragraph 4.51 of Section 4 of Part B of this Ethical Standard that an external independent quality control review is performed.**

6.6 Although an external independent quality control review is not required, nevertheless the *engagement partner* discloses the expectation that fees will amount to between 10% and 15% of the *firm's* annual fee income to the *Ethics Partner* and to those charged with governance of the *audited entity*.

Self-review Threat – Non-audit Services

6.7 **When undertaking *non-audit services* for a Small Entity *audited entity*, the *audit firm* is not required to apply safeguards to address a self-review threat provided:**

(a) the *audited entity* has '*informed management*'; and

(b) the *audit firm* extends the cyclical inspection of completed *audit engagements* that is performed for quality control purposes.

[60] In cases where a scheme with more than 100 members has been in wind-up over a number of years, such a scheme does not qualify as a Small Entity, even where the remaining number of members falls below 100.

6.8 The *audit firm* extends the number of *audit engagements* inspected under the requirements of ISQC (UK) 1 (Revised June 2016)[61] to include a random selection of *audit engagements* where *non-audit services* have been provided. Particular attention is given to ensuring that there is documentary evidence that '*informed management*' has made such judgments and decisions that are needed in relation to the presentation and disclosure of information in the financial statements.

6.9 Those inspecting the *audit engagements* are not involved in performing the *audit engagement*. Small *audit firms* may wish to use a suitably qualified external person or another *firm* to carry out *audit engagement* inspections.

6.10 In addition to the documentation requirements of ISQC (UK) 1 (Revised June 2016), those inspecting the *audit engagements* document their evaluation of whether the documentary evidence that '*informed management*' made such judgments and decisions that were needed in relation to the presentation and disclosure of information in the financial statements.

Exemptions

Management Threat – Non-audit Services

6.11 **When undertaking *non-audit services* for Small Entity audited entities, the *audit firm* is not required to adhere to the prohibitions in Section 5 of Part B of this Ethical Standard relating to providing *non-audit services* that involve the *audit firm* undertaking part of the role of management, provided that:**

(a) it discusses objectivity and independence issues related to the provision of *non-audit services* with those charged with governance, confirming that management accept responsibility for any decisions taken; and

(b) it discloses the fact that it has applied the FRC's Ethical Standard – Provisions Available for Audits of Small Entities, in accordance with paragraph 6.15.

Advocacy Threat – Non-audit Services

6.12 **The *audit firm* of a Small Entity is not required to comply with paragraphs 5.97 (tax services that involve acting as an advocate) and 5.140(b) (restructuring services that involve acting as an advocate) of Section 5 of Part B of this Ethical Standard, provided that it discloses the fact that it has applied the FRC's Ethical Standard – Provisions Available for Audits of Small Entities, in accordance with paragraph 6.15.**

---

[61] ISQC (UK) 1 (Revised June 2016) requires *audit firms* to establish policies and procedures which include a periodic inspection of a selection of completed engagements. Engagements selected for inspection include at least one engagement for each engagement partner over the inspection cycle, which ordinarily spans no more than three years.

Partners and Other Persons Approved as a Statutory Auditor Joining an Audited Entity

6.13 **The *audit firm* of a Small Entity is not required to comply with paragraphs 2.53 and 2.57 of Section 2 of Part B of this Ethical Standard, provided that:**

(a) it takes appropriate steps to determine that there is no significant threat to the *audit team's* integrity, objectivity and independence; and

(b) it discloses the fact that it has applied the FRC's Ethical Standard – Provisions Available for Audits of Small Entities, in accordance with paragraph 6.15.

6.14 An *audit firm* takes appropriate steps to determine that there is no significant threat to the *audit team's* integrity, objectivity and independence as a result of the employment of a former partner, or other person approved as a *statutory auditor*, by an *audited entity* that is a Small Entity by:

(a) assessing the significance of the self-interest, familiarity or intimidation threats, having regard to the following factors:

- the position the individual has taken at the *audited entity*;
- the nature and amount of any involvement the individual will have with the *audit team* or the audit process;
- the length of time that has passed since the individual was a member of the *audit team* or *firm*; and
- the former position of the individual within the *audit team* or *firm*, and

(b) if the threat is other than clearly insignificant, applying alternative procedures such as:

- considering the appropriateness or necessity of modifying the audit plan for the *audit engagement*;
- assigning an *audit team* to the subsequent *audit engagement* that is of sufficient experience in relation to the individual who has joined the *audited entity*;
- involving an audit partner or senior *staff* member with appropriate expertise, who, where the *firm* already audits the entity, was not a member of the *audit team*, to review the work done or otherwise advise as necessary; or
- undertaking an engagement quality control review of the *audit engagement*.

Disclosure Requirements

6.15 **Where the *audit firm* has taken advantage of an exemption provided in paragraphs 6.11, 6.12 or 6.13, the *engagement partner* shall ensure that:**

(a) the auditors' report discloses this fact, and

(b) either the financial statements, or the auditors' report, discloses the type of *non-audit services* provided to the *audited entity* or the

fact that a former *engagement partner*, or other person personally approved as a *statutory auditor*, has joined the *audited entity*.

6.16 The fact that an *audit firm* has taken advantage of an exemption provided by the FRC's Ethical Standard – Provisions Available for Small Entities is set out in a separate paragraph of the audit report. It does not affect the Opinion paragraph.

6.17 The *engagement partner* ensures that within the financial statements reference is made to the type of *non-audit services* provided to the *audited entity* or the fact that a former partner or other person personally approved as a *statutory auditor* has joined the *audited entity*. Where such a disclosure is not made within the financial statements it is included in the auditors' report.

APPENDIX: Illustrative template for communicating information on audit and non-audit services provided to the group

	Current year £m	Prior year £m
Audit of company	X	X
Audit of subsidiaries	X	X
Total audit	X	X
Audit related assurance services[62]	X	X
Other assurance services[63] [64]	X	X
Total assurance services	X	X
Tax compliance services (i.e. related to assistance with corporate tax returns)	X	X
Tax advisory services	X	X
Services relating to taxation	X	X
Internal audit services	X	X
Services related to corporate finance transactions not covered above	X	X
Other non-audit services not covered above	X	X
Total other non-audit services	X	X
Total non-audit services	X	X
Total fees	X	X
Occupational pension scheme audits	X	X
Non-audit services in respect of the audited entity provided to a third party[65].	X	X

[62] This will, and will only, include those services which are identified as audit related services in paragraph 5.41 of Section 5 of Part B of this Ethical Standard.

[63] This will not include any tax or internal audit services, all of which should be disclosed under those headings.

[64] The definition of an assurance engagement is provided in the Glossary of Terms on the FRC's website. Services provided under such engagements will include assurance engagements such as those which involve reporting on historical financial information which are included in an *investment circular* in accordance with the Standards for Investment Reporting 2000 (Revised): Investment reporting standards applicable to public reporting engagements on historical financial information.

[65] For the purposes of this Ethical Standard, *non-audit services* include services provided to another entity in respect of the *audited entity*, for example, where the *audit firm* provides transaction related services, in respect of an *audited entity's* financial information, to a prospective acquirer of the *audited entity* (see paragraph 5.8 of Section 5 of Part B of this Ethical Standard).

Disclosure of contingent fee arrangements under paragraph 4.25 of Section 4 of Part B of this Ethical Standard can also be facilitated through the use of a footnote to this template.

Disclosures required under UK company legislation[66] are indicated by those categories in bold type above. Fuller information can be provided by companies if desired.

[66] SI 2011/2198 "The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) (Amendment) Regulations 2011".

Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk