

APB ETHICAL STANDARD 2

FINANCIAL, BUSINESS, EMPLOYMENT AND PERSONAL RELATIONSHIPS

(Re-issued December 2004)

<i>Contents</i>	<i>paragraph</i>
Introduction	1 - 4
Financial relationships	5 - 24
Business relationships	25 - 31
Employment relationships	32 – 54
Family and other personal relationships	55 – 60
External consultants involved in the audit	61 - 63
Effective date	64 - 68

PREFACE

APB Ethical Standards apply in the audit of financial statements. They should be read in the context of the Auditing Practices Board's Statement "The Auditing Practices Board – Scope and Authority of Pronouncements (Revised)" which sets out the application and authority of APB Ethical Standards.

The terms used in APB Ethical Standards are explained in the Glossary.

APB Ethical Standards apply to audits of financial statements in both the private and the public sectors. However, auditors in the public sector are subject to more complex ethical requirements than their private sector counterparts. This includes, for example, compliance with legislation such as the Prevention of Corruption Act 1916, concerning gifts and hospitality, and with Cabinet Office guidance.

INTRODUCTION

- 1 APB Ethical Standard 1 requires the audit engagement partner to identify and assess the circumstances which could adversely affect the auditors' objectivity ('threats'), including any perceived loss of independence, and to apply procedures ('safeguards') which will either:

- (a) eliminate the threat; or
- (b) reduce the threat to an acceptable level (that is, a level at which it is not probable that a reasonable and informed third party would conclude that the auditors' objectivity and independence is impaired or is likely to be impaired).

When considering safeguards, where the audit engagement partner chooses to reduce rather than to eliminate a threat to objectivity and independence, he or she recognises that this judgment may not be shared by users of the financial statements and that he or she may be required to justify the decision.

- 2 This Standard provides requirements and guidance on specific circumstances arising out of financial, business, employment and personal relationships with the audit client, which may create threats to the auditors' objectivity or perceived loss of independence. It gives examples of safeguards that can, in some circumstances, eliminate the threat or reduce it to an acceptable level. In circumstances where this is not possible, either the relationship in question is not entered into or the auditors either do not accept or withdraw from the audit engagement, as appropriate.
- 3 Whenever a possible or actual breach of an APB Ethical Standard is identified, the audit 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 from the audit engagement.

- 4 An inadvertent violation of this Standard does not necessarily call into question the audit firm's ability to give an audit opinion provided that:
 - (a) the audit firm has established policies and procedures that require all partners and staff to report any breach promptly to the audit engagement partner or to the ethics partner as appropriate;
 - (b) the audit engagement partner or ethics partner promptly notifies the partner or member of staff 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, if appropriate, are applied (for example, having another partner review the work done by the relevant partner or member of staff or by removing him or her from the engagement team); and
 - (d) the actions taken and the rationale for them are documented.

FINANCIAL RELATIONSHIPS

General considerations

- 5 A financial interest is an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such an interest.
- 6 Financial interests may be:
 - (a) owned directly, rather than through intermediaries (a 'direct financial interest'); or
 - (b) owned through intermediaries, for example, an open ended investment company or a pension scheme (an 'indirect financial interest').

- 7 The audit firm, any partner in the audit firm, a person in a position to influence the conduct and outcome of the audit or an immediate family member of such a person should not hold:**
- (a) any direct financial interest in an audit client or an affiliate of an audit client; or**
 - (b) any indirect financial interest in an audit client or an affiliate of an audit client, where the investment is material to the audit firm or the individual and to the intermediary; or**
 - (c) any indirect financial interest in an audit client or an affiliate of an audit client, 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 investment in the audit client.**
- 8 The threats to the auditors' objectivity and independence, where a direct financial interest or a material indirect financial interest in the audit client is held by the audit firm or by one of the individuals specified in paragraph 7 are such that no safeguards can eliminate them or reduce them to an acceptable level.
- 9 For the purposes of paragraph 7, where holdings in an authorised unit or investment trust, an open ended investment company or an equivalent investment vehicle which is audited by the audit firm, are held by a partner in the audit firm, who is not in a position to influence the conduct and outcome of the audit, or an immediate family member of such a partner, these 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 audit client.
- 10 Where a person in a position to influence the conduct and outcome of the audit, or a partner in the audit firm, or any of their immediate family

members, are members or shareholders of an audit client, as a result of membership requirements, or equivalent, the audit firm ensures that no more than the minimum number of shares necessary to comply with the requirement are held and that this shareholding is not material to either the audit client or the individual. Disclosure of such shareholdings will be made to those charged with governance of the audit client, in accordance with APB Ethical Standard 1, paragraph 49.

- 11 Where one of the financial interests specified in paragraph 7 is held by:
- (a) *the audit firm, a partner in the audit firm or an immediate family member of such a partner*: the entire financial interest is disposed of, a sufficient amount of an indirect financial interest is disposed of so that the remaining interest is no longer material, or the firm does not accept (or withdraws from) the audit engagement;
 - (b) *a person in a position to influence the conduct and outcome of the audit*: the entire financial interest is disposed of, a sufficient amount of an indirect financial interest is disposed of so that the remaining interest is no longer material, or that person does not retain a position in which they exert such influence on the audit engagement;
 - (c) *an immediate family member of a person in a position to influence the conduct and outcome of the audit*: the entire financial interest is disposed of, a sufficient amount of an indirect financial interest is disposed of so that the remaining interest is no longer material, or the person in a position to influence the conduct and outcome of the audit does not retain a position in which they exert such influence on the audit engagement.
- 12 Where one of the financial interests specified in paragraph 7 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.

13 Where the disposal of a financial interest does not take place immediately, the audit firm adopts safeguards to preserve its objectivity until the financial interest is disposed. These may include the temporary exclusion of the person in a position to influence the conduct and outcome of the audit from such influence on the audit or a review of the relevant person's audit work by an audit partner having sufficient experience and authority to fulfill the role, who is not involved in the audit engagement.

14 Where the audit firm or one of the individuals specified in paragraph 7 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 audit client,

there may not be a threat to the auditors' 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 audit client 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 audit client is determined by the composition of the relevant index and there may be no threat to objectivity. As long as the person holding the indirect interest is not directly involved in the audit of the intermediary, nor able to influence the individual investment decisions of the intermediary, any threat to the auditors' objectivity and independence may be regarded as insignificant.

15 Where the audit firm or one of the individuals specified in paragraph 7 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 audit client, this means that they are unaware of the existence of an indirect financial interest. In

these circumstances, there is no threat to the auditors' objectivity and independence.

- 16 **Where a person in a position to influence the conduct and outcome of the audit or a partner in the audit firm becomes aware that a close family member holds one of the financial interests specified in paragraph 7, that individual should report the matter to the audit engagement partner to take appropriate action. If it is a close family member of the audit engagement partner, or if the audit engagement partner is in doubt as to the action to be taken, the audit engagement partner should resolve the matter through consultation with the ethics partner.**

Financial interests held as trustee

- 17 Where a direct or an indirect financial interest in the audit client or its affiliates is held in a trustee capacity by a person in a position to influence the conduct and outcome of the audit, or an immediate family member of such a person, a self-interest threat may be created because either the existence of the trustee interest may influence the conduct of the audit or the trust may influence the actions of the audit client. Accordingly, such a trustee interest is only held when:
- the relevant person is not an identified potential beneficiary of the trust; and
 - the financial interest held by the trust in the audit client is not material to the trust; and
 - the trust is not able to exercise significant influence over the audit client or an affiliate of the audit client; and
 - the relevant person does not have significant influence over the investment decisions made by the trust, in so far as they relate to the financial interest in the audit client.
- 18 Where it is not clear whether the financial interest held by the trust in the audit client is material to the trust or whether the trust is able to exercise

significant influence over the audit client, the financial interest is reported to the ethics partner, so that a decision can be made as to the steps that need to be taken.

Financial interests held by audit firm pension schemes

- 19 Where the pension scheme of an audit firm has a financial interest in an audit client or its 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 an acceptable level. 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

- 20 Where audit firms, persons in a position to influence the conduct and outcome of the audit or immediate family members of such persons:
- (a) accept a loan¹ or a guarantee of their borrowings from an audit client; or
 - (b) make a loan to or guarantee the borrowings of an audit client,
- a self-interest threat and an intimidation threat to the auditors' objectivity can be created or there may be a perceived loss of independence. In a number of situations, no safeguards can eliminate this threat or reduce it to an acceptable level.

¹ For the purpose of this 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 26).

- 21 **Audit firms, persons in a position to influence the conduct and outcome of the audit and immediate family members of such persons should not make a loan to, or guarantee the borrowings of, an audit client or its affiliates 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.**
- 22 **Audit firms should not accept a loan from, or have their borrowings guaranteed by, the audit client or its affiliates unless:**
- (a) the audit client 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 audit firm and the audit client.**
- 23 **Persons in a position to influence the conduct and outcome of the audit and immediate family members of such persons should not accept a loan from, or have their borrowings guaranteed by, the audit client or its affiliates unless:**
- (a) the audit client 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 audit client.**
- 24 Loans by an audit client that is a bank or similar institution to a person in a position to influence the conduct and outcome of the audit, or an immediate family member of such a person (for example, home mortgages, bank overdrafts or car loans), do not create an unacceptable threat to objectivity and independence, provided that normal business terms apply. However, where such loans are in arrears by a significant amount, this creates an intimidation threat that is unacceptable. Where such a situation arises, the person in a position to influence the conduct

and outcome of the audit reports the matter to the audit engagement partner, or to the ethics partner, as appropriate and ceases to have any involvement with the audit. The audit engagement partner or, where appropriate, the ethics partner considers whether any audit work is to be reperformed.

BUSINESS RELATIONSHIPS

- 25 A business relationship between:
- (a) the audit firm or a person who is in a position to influence the conduct and outcome of the audit, or an immediate family member of such a person, and
 - (b) the audit client or its affiliates, or its management
- involves the two parties having a common commercial interest. Business relationships may create self-interest, advocacy or intimidation threats to the auditors' objectivity and perceived loss of independence. Examples include:
- joint ventures with the audit client or with a director, officer or other individual who performs senior managerial functions for the client;
 - arrangements to combine one or more services or products of the audit firm with one or more services or products of the audit client and to market the package with reference to both parties;
 - distribution or marketing arrangements under which the audit firm acts as a distributor or marketer of any of the audit client's products or services, or the audit client acts as the distributor or marketer of any of the products or services of the audit firm;
 - other commercial transactions, such as the audit firm leasing its office space from the audit client.
- 26 **Audit firms, persons in a position to influence the conduct and outcome of the audit and immediate family members of such persons should not enter into business relationships with an audit**

client or its affiliates except where they involve the purchase of goods and services from the audit firm or the audit client in the ordinary course of business and on an arm's length basis and the value involved is not material to either party.

- 27 Where a business relationship is not in the ordinary course of business, or where it is not on an arm's length basis, or where the value involved is material, and has been entered into by:
- (a) *the audit firm*: either the relationship is terminated or the firm does not accept (or withdraws from) the audit engagement;
 - (b) *a person in a position to influence the conduct and outcome of the audit*: either the relationship is terminated or that person does not retain a position in which they exert such influence on the audit engagement;
 - (c) *an immediate family member of a person in a position to influence the conduct and outcome of the audit*: either the relationship is terminated or that person does not retain a position in which they exert such influence on the audit engagement.

Where there is an unavoidable delay in the termination of a business relationship, the audit firm adopts safeguards to preserve its objectivity until the relationship is terminated. These may include a review of the relevant person's audit work or a temporary exclusion of the relevant person from influence on conduct and outcome of the audit.

- 28 **Where a person in a position to influence the conduct and outcome of the audit becomes aware that a close family member has entered into one of the business relationships specified in paragraph 25, that individual should report the matter to the audit engagement partner to take appropriate action. If it is a close family member of the audit engagement partner or if the audit engagement partner is in doubt as to the action to be taken, the audit engagement partner should resolve the matter through consultation with the ethics partner.**

- 29 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 audit firm's objectivity and independence, the audit engagement partner reports the issue:
- to the ethics partner, 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
 - to those charged with governance of the audit client, together with other significant facts and matters that bear upon the auditors' objectivity and independence, to obtain their views on the matter.
- 30 **An audit firm should not provide audit services to any entity or person able to influence the affairs of the audit firm or the performance of any audit engagement undertaken by the audit firm.**
- 31 This prohibition applies to:
- (a) any entity that owns any significant part of an audit 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 materially to influence the policy of an entity.²

² For companies, competition authorities have generally treated a 15% shareholding as sufficient to provide a material ability to influence policy.

EMPLOYMENT RELATIONSHIPS

MANAGEMENT ROLE WITH AUDIT CLIENT

- 32 **An audit firm should not admit to the partnership or employ a person to undertake audit work if that person is also employed by the audit client or its affiliates ('dual employment').**

Loan staff assignments

- 33 **An audit firm should not enter into an agreement with an audit client to provide a partner or employee to work for a temporary period as if that individual were an employee of the audit client or its affiliates (a 'loan staff assignment') unless the audit client:**
- (a) agrees that the individual concerned will not hold a management position, and**
 - (b) 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 audit client to a particular position or accounting treatment.**

- 34 **Where an audit firm agrees to assist an audit client 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. Thus, for example, interim management arrangements involving participation in the financial reporting function are not acceptable.**

- 35 **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 client's**

financial statements and then, on completion of that assignment, is assigned to the engagement team for that client, with responsibility to report on matters for which he or she was responsible whilst on that loan staff assignment.

- 36 Where a partner or employee returns to the firm on completion of a loan staff assignment, that individual should not be given any role on the audit involving any function or activity that he or she performed or supervised during that assignment.**
- 37 In considering for how long this restriction is to be observed, the need to realise the potential value to the effectiveness of the audit of the increased knowledge of the client's business gained through the assignment has to be weighed against the potential threats to objectivity and independence. 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 first audit of the financial statements following the completion of the loan staff assignment.

Partners and engagement team members joining an audit client

- 38 Where a former partner in the audit firm joins the audit client, the audit firm should take action as quickly as possible - and, in any event, before any further work is done by the audit firm in connection with the audit - to ensure that no significant connections remain between the firm and the individual.**
- 39 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 audit firm's business or professional activities.

40 **Audit firms should establish policies and procedures that require:**

(a) all partners in the audit firm to notify the firm of any situation involving their potential employment with any audit client of the firm; and

(b) senior members of any engagement team to notify the audit firm of any situation involving their potential employment with the relevant audit client; and

(c) other members of any engagement team to notify the audit firm of any situation involving their probable employment with the relevant audit client; and

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

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

41 Objectivity and independence may be threatened where a director, an officer or an employee of the audit client who is in a position to exert direct and significant influence over the preparation of the financial statements has recently been a partner in the audit firm or a member of the engagement team. Such circumstances may create self-interest, familiarity and intimidation threats, particularly when significant connections remain between the individual and the audit firm. Similarly, objectivity and independence may be threatened when an individual knows, or has reason to believe that he or she will or may be joining the audit client at some time in the future.

42 Where a partner in the audit firm or a member of the engagement team for a particular audit client has left the audit firm and taken up

employment with that audit client, 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 audit client;
- 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 audit firm.

Following the assessment of any such threats, appropriate safeguards are applied where necessary.

- 43 Any review of audit work is performed by a more senior audit professional. If the individual joining the client is an audit partner, the review is performed by an audit partner who is not involved in the audit engagement. Where, due to its size, the audit firm does not have a partner who was not involved in the audit engagement, it seeks either a review by another audit firm or advice from its professional body.
- 44 **Where a partner leaves the firm and is appointed as a director (including as a non-executive director) or to a key management position with an audit client, having acted as audit engagement partner (or as an independent partner, key audit partner or a partner in the chain of command) at any time in the two years prior to this appointment, the firm should resign as auditors.³ The firm should not accept re-appointment as auditors until a two-year period, commencing when the former partner ceased to act for the client, has elapsed or the former partner ceases employment with the**

³ The timing of the audit firm's resignation as auditors is determined in accordance with paragraph 40 of APB Ethical Standard 1. In the case of those public sector bodies where the responsibility for the audit is assigned by legislation, the auditors cannot resign from the audit engagement and they consider alternative safeguards that they can put in place.

former client, whichever is the sooner.

- 45 **Where a former member of the engagement team (other than an audit engagement partner, a key audit partner or a partner in the chain of command) leaves the audit firm and, within two years of ceasing to hold that position, joins the audit client as a director (including as a non-executive director) or in a key management position, the audit firm should consider whether the composition of the audit team is appropriate.**
- 46 In such circumstances, the audit firm evaluates the appropriateness of the composition of the audit team by reference to the factors listed in paragraph 42 and alters or strengthens the audit team to address any threat to the auditors' objectivity and independence that may be identified.

Family members employed by an audit client

- 47 **Where a person in a position to influence the conduct and outcome of the audit, or a partner in the audit firm, becomes aware that an immediate or close family member is employed by an audit client in a position to exercise influence on the accounting records or financial statements, that individual should either:**
- (a) in the case of an immediate family member of a person in a position to influence the conduct and outcome of the audit, cease to hold a position in which they exert such influence on the audit; or**
 - (b) in the case of a close family member of a person in a position to influence the conduct and outcome of the audit, or any family member of a partner in the audit firm, report the matter to the audit engagement partner to take appropriate action. If it is a close family member of the audit engagement partner or if the audit engagement partner is in doubt as to the action to be**

taken, the audit engagement partner should resolve the matter in consultation with the ethics partner.

GOVERNANCE ROLE WITH AUDIT CLIENT

- 48 Paragraphs 49 to 51 are supplementary to certain statutory or regulatory provisions that prohibit directors of entities from being appointed as their auditors.⁴
- 49 **A partner or employee of the audit firm who undertakes audit work should not accept appointment:**
- (a) to the board of directors of the audit client;**
 - (b) to any subcommittee of that board; or**
 - (c) to such a position in an entity which holds directly or indirectly more than 20% of the voting rights in the audit client, or in which the audit client holds directly or indirectly more than 20% of the voting rights.**
- 50 **Where a person in a position to influence the conduct and outcome of the audit has an immediate or close family member who holds a position described in paragraph 49, the audit firm should take appropriate steps to ensure that the relevant person does not retain a position in which they exert influence on the conduct and outcome of the audit engagement.**

⁴ In the case of limited companies, for example, section 27 of the Companies Act 1989 contains detailed provisions. Amongst other things, these state that:

‘...A person is ineligible for appointment as company auditor of a company if he is (a) an officer or employee of the company, or (b) a partner or employee of such a person, or a partnership of which such a person is a partner, or if he is ineligible by virtue of paragraph (a) or (b) for appointment as company auditor of any associated undertaking of the company.’

- 51 **Where a partner or employee of the audit firm, not being a member of the engagement team, has an immediate or close family member who holds a position described in paragraph 49, that individual should report that fact to the audit engagement partner, who should consider whether the relationship might be regarded by a reasonable and informed third party as impairing, or being thought to impair, the auditors' objectivity. If the audit engagement partner concludes that the auditors' objectivity may be impaired, that individual should consult with the ethics partner to determine whether appropriate safeguards exist. If no such safeguards exist, the audit firm withdraws from the audit engagement.**

EMPLOYMENT WITH AUDIT FIRM

- 52 Objectivity and independence may be threatened where a former director or employee of the audit client becomes a member of the engagement team. 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 elements of the financial statements for which he or she had responsibility, while with the audit client.
- 53 **Where a former director or a former employee of an audit client, who was in a position to exert significant influence over the preparation of the financial statements, joins the audit firm, that individual should not be assigned to a position in which he or she is able to influence the conduct and outcome of the audit for that client or its affiliates for a period of two years following the date of leaving the audit client.**
- 54 In certain circumstances, a longer period of exclusion from the engagement team may be appropriate. For example, threats to objectivity and independence may exist in relation to the audit of the

financial statements of any period which are materially affected by the work of that person whilst occupying his or her former position of influence with the audit client. The significance of these threats depends on factors such as:

- the position the individual held with the audit client;
- the length of time since the individual left the audit client;
- the position the individual holds in the engagement team.

FAMILY AND OTHER PERSONAL RELATIONSHIPS

55 A relationship between a person who is in a position to influence the conduct and outcome of the audit and another party does not generally affect the consideration of the auditors' objectivity and independence. However, if it is a family relationship, and if the family member also has a financial, business or employment relationship with the audit client, then self-interest, familiarity or intimidation threats to the auditors' objectivity and independence may be created. The significance of any such threats depends on such factors as:

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

56 A distinction is made between immediate family relationships and close family relationships. Immediate family members comprise an individual's spouse (or equivalent) and dependents, whereas close family members comprise parents, non-dependent children and siblings. While an individual can usually be presumed to be aware of matters concerning his or her immediate family members 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.

- 57 When considering family relationships, it needs to be acknowledged that, in an increasingly secular, open and inclusive society, 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.
- 58 **The audit firm should establish policies and procedures that require:**
- (a) partners and professional staff to report to the audit firm any immediate family, close family and other personal relationships involving an audit client of the firm, to which they are a party and which they consider might create a threat to the auditors' objectivity or a perceived loss of independence;**
 - (b) the relevant audit engagement partners to be notified promptly of any immediate family, close family and other personal relationships reported by partners and other professional staff.**
- 59 **The audit engagement partner should:**
- (a) assess the threats to the auditors' objectivity and independence arising from immediate family, close family and other personal relationships on the basis of the information reported to the firm by persons in a position to influence the conduct and outcome of the audit;**
 - (b) apply appropriate safeguards to eliminate the threat or reduce it to an acceptable level; and**
 - (c) where there are unresolved matters or the need for clarification, consult with the ethics partner.**
- 60 Where such matters are identified or reported, the audit engagement partner or the ethics partner assesses the information available and the potential for there to be a threat to the auditors' objectivity and

independence, treating any personal relationship as if it were a family relationship.

EXTERNAL CONSULTANTS INVOLVED IN THE AUDIT

- 61 Audit firms may employ external consultants as experts in order to obtain sufficient appropriate audit evidence regarding certain financial statement assertions.⁵ There is a risk that an expert's objectivity and independence will be impaired if the expert is related to the entity, for example by being financially dependent upon or having an investment in, the entity.
- 62 The audit engagement partner should be satisfied that any external consultant involved in the audit will be objective and document the rationale for that conclusion.**
- 63 The audit engagement partner obtains information from the external consultant as to the existence of any connections that they have with the audit client including:
- financial interests;
 - business relationships;
 - employment (past, present and future);
 - family and other personal relationships.

EFFECTIVE DATE

- 64 Effective for audits of financial statements for periods commencing on or after 15 December 2004.

⁵ ISA (UK and Ireland) 620 *'Using the work of an Expert'* states that the auditor should evaluate the objectivity of the expert.

- 65 Firms may complete audit engagements relating to periods commencing prior to 15 December 2004 in accordance with existing ethical guidance from the relevant professional body, putting in place any necessary changes in the subsequent engagement period.
- 66 Financial interests held at 15 December 2004 that were permissible in accordance with existing ethical guidance (including transitional arrangements) from the relevant professional body, but are prohibited by the requirements of paragraphs 5 to 24, may continue to be held for up to twelve months after that date provided that:
- no new interest is acquired; and
 - the audit firm satisfies itself that there are adequate safeguards in place to reduce the threat to acceptable levels.
- 67 Business relationships existing at 15 December 2004 that were permissible in accordance with existing ethical guidance (including transitional arrangements) from the relevant professional body, but are prohibited by the requirements of paragraphs 25 to 31, may continue to exist for up to twelve months after that date provided that:
- no new contracts under the business relationship are entered into; and
 - the audit firm satisfies itself that there are adequate safeguards in place to reduce the threat to acceptable levels.
- 68 The requirements of paragraph 44 in respect of employment with the audit client do not apply if:
- the relevant person has notified an intention to join the client prior to 5 October 2004 or has entered into contractual arrangements prior to that date; and
 - the continuation of the audit relationship was permitted by existing ethical guidance (including transitional arrangements) from the relevant professional body.

NOTICE TO READERS

© The Auditing Practices Board Limited

This document has been obtained from the website of the Financial Reporting Council (FRC) and its subsidiary Boards, which includes the Auditing Practices Board (APB). Use of the website is subject to the WEBSITE TERMS OF USE, which may be viewed in a separate section of the website. Readers should be aware that although the FRC and its subsidiary Boards seek to ensure the accuracy of information on the website, no guarantee or warranty is given or implied that such information is free from error or suitable for any given purpose: the published hard copy alone constitutes the definitive text.