

APB ETHICAL STANDARD 3

LONG ASSOCIATION WITH THE AUDIT ENGAGEMENT

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Contents	paragraph
Introduction	1 - 4
General provisions	5 - 11
Additional provisions related to audits of listed companies	12 - 18
Effective date	19 - 22

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 either 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 long association with the audit engagement, 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, 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 ensures that any matter which has given rise to a breach is addressed as soon as possible;
 - (c) safeguards, if appropriate, are applied (for example, by 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.

GENERAL PROVISIONS

- 5 **The audit firm should establish policies and procedures to monitor the length of time that audit engagement partners, key audit partners and staff in senior positions serve as members of the engagement team for each audit.**
- 6 **Where audit engagement partners, key audit partners and staff in senior positions have a long association with the audit, the audit firm should assess the threats to the auditors' objectivity and independence and, where the threats are other than clearly insignificant, should apply safeguards to reduce the threats to an acceptable level. Where appropriate safeguards cannot be applied, the audit firm should either resign as auditors or not stand for reappointment, as appropriate.¹**

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.

- 7 Where audit engagement partners, key audit partners and staff in senior positions have a long association with the audit client, self-interest, self-review and familiarity threats to the auditors' objectivity may arise. Similarly, such circumstances may result in an actual or perceived loss of independence. The significance of such threats depends upon factors such as:
- the role of the individual in the engagement team;
 - the proportion of time that the audit client contributes to the individual's annual billable hours;
 - the length of time that the individual has been associated with that audit engagement.
- 8 In order to address such threats, audit firms apply safeguards. Appropriate safeguards may include:
- removing ('rotating') the audit 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 audit partners and the other senior members of the engagement team and to advise as necessary;
 - applying independent internal quality reviews to the engagement in question.
- 9 Once an audit engagement partner has held this role for a continuous period of ten years, careful consideration is given as to whether a reasonable and informed third party would consider the audit firm's objectivity and independence to be impaired. Where the individual concerned is not rotated after ten years, it is important that:
- (a) alternative safeguards such as those noted in paragraph 8 are applied; or

- (b) (i) the reasoning as to why the individual continues to participate in the audit engagement is documented; and
 - (ii) the facts are communicated to those charged with governance of the audit client in accordance with paragraphs 49-53 of APB Ethical Standard 1.

- 10 The audit firm's policies and procedures set out the circumstances in which the audit engagement partners responsible for the audits of non-listed clients are subject to accelerated rotation requirements, such as those set out in paragraph 12. These policies take into consideration the nature of the entity's business, its size, the number of its employees and the range of its stakeholders in addition to the factors set out in paragraph 7.

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

ADDITIONAL PROVISIONS RELATED TO AUDITS OF LISTED COMPANIES

The audit engagement partner and the independent partner

- 12 **In the case of listed companies, save where the circumstances contemplated in paragraph 13 and 14 apply, the audit firm should establish policies and procedures to ensure that:**
 - (a) no one should act as audit engagement partner or as independent partner for a continuous period longer than five years;**

- (b) where an independent partner becomes the audit engagement partner, the combined period of service in these positions should not exceed five years; and**
- (c) anyone who has acted as the audit engagement partner or the independent partner, or held a combination of such positions, for a particular audit client for a period of five years, whether continuously or in aggregate, should not hold any position of responsibility in relation to the audit engagement, until a further period of five years has elapsed.**
- 13 When an audit client becomes a listed company, the length of time the audit engagement partner has served the audit client in that capacity is taken into account in calculating the period before the audit engagement partner is rotated off the engagement team. However, where the audit engagement partner has already served for four or more years, that individual may continue to serve as the audit engagement partner for not more than two years after the audit client becomes a listed company.
- 14 Some degree of flexibility over the timing of rotation may be necessary in circumstances where a reasonable and informed third party would regard the audit engagement partner's continuity as being especially important to the shareholders of the audit client. For example, where major changes to the audit client's structure or its senior management are expected that would otherwise coincide with the rotation of the audit engagement partner. In these circumstances alternative safeguards are applied to reduce any threats to an acceptable level. Such safeguards may include ensuring that an expanded review of the audit work is undertaken by an audit partner, who is not involved in the audit engagement.
- 15 In the case of joint audit arrangements for listed companies, audit firms will make arrangements for changes of audit engagement partners and independent 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.

Key audit partners

- 16 **In the case of listed companies, the audit firm should establish policies and procedures to ensure that:**
- (a) no one should act as a key audit partner for a continuous period longer than seven years;**
 - (b) where a key audit partner becomes the audit engagement partner, the combined period of service in these positions should not exceed seven years; and**
 - (c) anyone who has acted as a key audit partner for a particular audit client for a period of seven years, whether continuously or in aggregate, should not hold any position of responsibility in relation to the audit engagement until a further period of two years has elapsed.**

Other partners and staff in senior positions

- 17 **In the case of listed companies, the audit engagement partner should review the safeguards put in place to address the threats to the auditors' objectivity and independence arising where:**
- (a) partners have been responsible for significant affiliates (but not as key audit partners); or**
 - (b) staff have been involved in the audit in senior positions; for a continuous period longer than seven years and should discuss those situations with the independent partner. Any unresolved problems or issues should be referred to the ethics partner.**
- 18 Such safeguards might include the removal of the member of staff from, or the rotation of roles within, the engagement team.

EFFECTIVE DATE

- 19 Effective for audits of financial statements for periods commencing on or after 15 December 2004.
- 20 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.
- 21 Firms may implement revisions to their policies and procedures as required under paragraph 5 during the year commencing 15 December 2004.
- 22 Where the provisions of paragraphs 12 and 16 require audit partners to rotate off the audit engagement prior to the period allowed by existing ethical guidance (including transitional arrangements) from the relevant professional body, they may continue where a change would impair audit quality. However, this extension beyond the period permitted by paragraphs 12 and 16 can be applied only for audits of financial statements for periods commencing on or prior to 15 December 2006.

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