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Enhancing Confidence in Audit: Proposed Revisions to the Ethical Standard, Auditing Standards, UK Corporate Governance Code and Guidance on Audit Committees

Annex 1: Revised Ethical Standard

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ETHICAL STANDARD (2016)

INTEGRITY, OBJECTIVITY AND INDEPENDENCE

<i>Contents</i>	<i>page</i>
Introduction	
Scope of this Ethical Standard	6
Meeting the Ethical Outcomes Established by the Overarching Principles, Supporting Ethical Provisions and Specific Requirements	7
The EU Audit Directive and Regulation	10
Investment Circular Reporting Engagements	11
Definitions	11
Part A	
Overarching Principles and Supporting Ethical Provisions	
Integrity and Objectivity	17
Overarching Principle	17
Supporting Ethical Provisions	17
Independence	17
Overarching Principle	17
Supporting Ethical Provisions	18
Part B	
Section 1 – General Requirements and Guidance	
Compliance with Ethical Requirements	21
Identification and Assessment of Threats	27
Threats to Integrity, Objectivity and Independence	28
Investment Circular Reporting Engagements	32

Identification and Assessment of Safeguards	34
Other Firms Involved in Group Audit or Other Public Interest Assurance Engagements	35
Engagement Quality Control Review	36
Overall Conclusion	36
Communication with Those Charged With Governance	37
Additional Requirements Related to Public Interest Entities and to Other Listed Entities	38
Documentation	40
Effective date	41

Section 2 – Financial, business, Employment and Personal Relationships

Financial relationships	42
General Considerations	42
Financial Interests Held as Trustee	46
Financial Interests Held by Firm Pension Schemes	47
Loans and Guarantees	47
Business relationships	48
Employment relationships	51
Management Role with an Entity Relevant to an Audit or Other Public Interest Assurance Engagement	51
Loan Staff Assignments	51
Partners and Engagement Team Members Joining an Entity Relevant to an Audit or Other Public Interest Assurance Engagement	52
Family Members Employed by an Entity Relevant to an Audit or Other Public Interest Assurance Engagement	55
Governance Role with an Entity Relevant to an Audit or Other Public Interest Assurance Engagement	56
Employment with the Firm	57
Family and Other Personal Relationships	58

External Consultants Involved in the Audit or Other Public Interest Assurance Engagement	59
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Section 3 – Long Association with Engagements and with Entities Relevant to Engagements

General Requirements	60
Public Interest Entities and Other Listed Entities	61
Audit Firm Rotation	61
The Engagement Partner	61
Engagement Quality Control Reviewers and Other Key Partners Involved in the Engagement	63
Other Partners and Staff in Senior Positions	64

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

Fees	66
Remuneration and Evaluation Policies	74
Gifts and Hospitality	76
Threatened and Actual Litigation	76

Section 5 – Non-audit / Additional Services

General Approach to Non-audit / Additional Services	78
Investment Circular Reporting Engagements	81
Identification and Assessment of Threats and Safeguards	82
Threats to Objectivity and Independence	84
Safeguards	89
Communication with Those Charged With Governance	90
Documentation	91
Audit Related Services	92
Prohibited Non-audit Services for Public Interest Entities	92
Evaluation of Specific Non-audit Services and Additional Services	96

Internal Audit services	97
Information Technology Services	100
Valuation Services	101
Actuarial Valuation Services	103
Tax Services	103
Litigation Support Services	107
Legal Services	108
Recruitment and Remuneration Services	108
Corporate Finance Services	110
Transaction Related Services	114
Restructuring Services	116
Accounting Services	119
Appendix: Illustrative template for communicating information on audit and non-audit services provided to the group	122

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"¹ 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.

¹ To be updated in the light of final changes resulting from the FRC's proposals

Introduction

Scope of this Ethical Standard

- 11 This Ethical Standard applies to audit engagements and other public interest assurance engagements². 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*'³ – 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 condition and performance of the entity).
- 12 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 the entity(ies) but do not have direct access to the subject matter.
- 13 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 audit or other assurance engagement then addresses the need for trust and confidence between the users and the directors of the entity.
- 14 In the context of an audit or other public interest assurance 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

² Audits of financial statements^(a) undertaken in compliance with International Standards on Auditing (ISAs) (UK and Ireland) and other public interest assurance engagements undertaken in compliance with performance standards issued by the FRC which, as of [date], 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).

^(a) 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.

³ '*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.

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 auditor or assurance practitioner is unduly influenced by them, because this may prejudice the interests of the intended users, which should be paramount.

- 15 Users do not have all the information necessary for judging whether the firm, its partners and staff and any other persons in a position to influence the conduct or outcome of an engagement 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, a third party may reach a different conclusion. For example, if a third party were aware that the firm, its partners or staff and/or any other persons in a position to influence the conduct or outcome of the engagement had certain financial, employment, business or personal relationships with the responsible entity(ies), that third party might reasonably conclude that the firm, its partners or staff and such persons could be subject to undue influence from the directors of such entity(ies) 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. [ES 1.14]

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

- 16 This Ethical Standard sets out the overarching principles of integrity, objectivity and independence, together with supporting ethical provisions and specific requirements relevant to audit and other public interest assurance engagements. Together, these establish a framework, of ethical outcomes that are required to be met by the auditor or assurance practitioner, that is intended to provide a basis for user trust and confidence in the integrity and objectivity of the practitioner in performing the engagement.
- 17 Importantly, the link to user (third party) trust and confidence is established through the requirement, in this Ethical Standard, for the impact of conditions and relationships with inherent conflicts of interest that create threats to integrity and objectivity which may compromise independence. Any mitigations (safeguards) applied, should be evaluated by reference to the perspective of an objective, reasonable and informed third party (see the definition of *independence*).
- 18 The firm, as well as each person in a position to influence the conduct or outcome of the engagement, 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 other persons in a position to influence

the conduct or outcome of an engagement 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 that an objective, reasonable and informed third party would not conclude that integrity or objectivity (and therefore independence) is compromised.

- I9 When the threats that exist mean that this outcome cannot be met, the third party would not have sufficient trust and confidence in the practitioner to want them 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 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 law.
- I10 The sources of such conflicts of interest lie in the conditions and relationships that may give rise to threats to integrity and objectivity in the performance of the engagement. Most directly, such conditions and relationships may impact those responsible for the performance of the engagement. However, those individuals perform the engagement 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.
- I11 Conditions and relationships that affect the firm or its network firms and their partners and staff and any other persons in a position to influence the conduct or outcome of an engagement are therefore also 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. Conditions and relationships that are relevant in the context of the engagement may arise within the firm or its network or externally.
- I12 Relevant internal conditions would include, for example, the culture, governance and management 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 in a position to influence the conduct or outcome of the engagement.
- I13 Relevant external relationships would include, for example: family and personal relationships of persons in a position to influence the conduct or outcome of the engagement; financial, business and employment relationships of the firm or such individuals (or closely connected persons) with the responsible entity(ies) and potentially with other entities related to the engagement; and relationships with the responsible entity(ies) that arise in the performance of the audit or other public interest assurance engagement

or any other engagements with those entities. Relevant external conditions may include, for example: the culture, governance and management of the responsible entity(ies); long association of those performing the engagement with the responsible entity(ies); and economic dependence on the responsible entity(ies).

- I14 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.
- I15 In relation to historical financial information included in an investment circular, directors have to form a view as to whether it is necessary to make adjustments to previously published financial statements. If the directors, whether deliberately or inadvertently, make a biased judgment or an otherwise inappropriate decision, the financial statements or other subject matter information or subject matter that is the subject of a public interest assurance engagement may be misstated or misleading. [ES 1.11, ESRA 1.10]
- I16 The FRC believes that stakeholders (users of practitioner's reports issued under such engagements) expect an equivalent standard of independence for firms, their partners and other persons in a position to influence the conduct or outcome of an engagement, whether performing audit or other public interest assurance engagements.1.2 Firms, 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.
- I17 The specific requirements are designed to assist in meeting the ethical outcomes required by the overarching principles and supporting ethical provisions. However, circumstances relating to audit and other public interest assurance engagements vary widely and meeting the ethical outcomes required by the overarching principles and supporting provisions is paramount. Compliance with the specific requirements may not be sufficient to do so. 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 reported relevant conditions and circumstances, including establishing, maintaining or complying 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.

- I18 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.
- I19 Other regulators or competent authorities may specify compliance with this Ethical Standard in relation to other types of work.
- I20 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 audit or other public interest assurance engagement is professionally sound. [ES 1.5]

The EU Audit Directive and Regulation

- I21 In May 2014 the European Commission published a Directive⁴ amending the Statutory Audit Directive⁵ and a new Audit Regulation⁶. 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).
- I22 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.
- I23 The Department for Business Innovation and Skills (BIS) determined that it would be appropriate for the application of the provisions that clearly relate to matters currently covered by the FRC’s standards to be allocated to the FRC to implement via the audit and ethical standards framework and revision of the relevant standards. Accordingly, 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.

Investment Circular Reporting Engagements

- I24 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

⁴ Directive 2014/56/EU

⁵ Directive 2006/43/EC

⁶ Regulation 537/2014

by only a limited number of individuals within the firm. For this reason, for such engagements, the requirements of this Ethical Standard apply only to.

- (a) persons with actual knowledge of the engagement as described the definition of *persons in a position to influence the conduct or outcome of the engagement* applicable to an investment circular reporting engagement; and
- (b) where required by this Ethical Standard, the firm. [ESRA 1.17]

Definitions

I25 The terms used in the FRC's Ethical Standard are explained in the Glossary which is available on the FRC website. This includes the terms below.

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 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.

Independence – freedom from conditions and relationships in respect of which, in the context of an engagement, would compromise the integrity or objectivity of the firm or persons in a position to influence the conduct or outcome of the engagement.

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.

Other Terms

These are new or amended definitions compared to the current FRC Ethical Standards. They will not be included in the new Ethical Standard when it is finalised but rather will be included in an updated Glossary of Terms for the auditing and ethical standards.

Audit engagement – an engagement to perform an audit in accordance with the International Standards on Auditing (UK and Ireland) and, where applicable, relevant legislation. It includes a *statutory audit* performed pursuant to the EU Audit Directive and Regulation or otherwise designated by national law as a statutory audit.

Engagement partner - The partner(s) or other person(s) in the firm who are responsible for the audit or other public interest assurance engagement and its performance and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body. For an audit, the engagement partner is a '*key audit partner*'.

Engagement team - All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm.

For the purposes of this Ethical Standard, engagement team comprises all persons who are directly involved in the acceptance and performance of a particular audit or other public interest assurance engagement. This includes the audit / assurance team, professional personnel from other disciplines involved in the engagement and those who provide quality control (other than the engagement quality control reviewer) or direct oversight of the engagement, but it does not include any external experts contracted by the firm.

Engagement(s) – In this Ethical Standard, an audit engagement(s) or an other public interest assurance engagement(s), or both where the context permits.

Entity relevant to the engagement – is an entity with respect to which the firm and persons in a position to influence the conduct or outcome of an engagement are required to be independent. In the case of an audit engagement, the entity relevant to the engagement is the audited entity, which is responsible for the audited financial statements. In the case of an other public interest assurance engagement, an entity relevant to the engagement is any entity responsible for the subject matter information of the engagement (except when the responsible entity is the assurance practitioner) or the subject matter of the engagement or (where applicable) both.

In relation to an investment circular reporting engagement, entities relevant to the engagement include the entity responsible for issuing the investment circular containing the financial information (the issuing engagement entity) and, if different, the entity on whose financial information the firm is reporting.

Firm – The sole practitioner, partnership, limited liability partnership or other corporate entity engaged in the provision of audit services or other public interest assurance engagements. This includes a '*statutory auditor*' who is a natural person; and a legal person or any other entity, regardless of its legal form, with the appropriate approval to carry out statutory audits. For the purpose of this Ethical Standard, '*firm*' also includes network firms in the UK and Ireland, which are controlled by the audit firm or its partners.

Key audit partner(s) – These are defined in Article 2.16 of the EU Audit Directive as:

- (a) the statutory auditor(s) designated by an audit firm for a particular audit engagement as being primarily responsible for carrying out the *statutory audit* on behalf of the audit firm; or
- (b) in the case of a group audit, at least the statutory auditor(s) designated by an audit firm as being primarily responsible for carrying out the *statutory audit* at the level of the group and the statutory auditor(s) designated as being primarily responsible at the level of material subsidiaries; or
- (c) the statutory auditor(s) who sign(s) the audit report.

Key partner involved in the engagement - A partner, or other person in the engagement team (other than the engagement partner or engagement quality control reviewer), who either:

- is involved at the group level and is responsible for key aspects of the engagement, including decisions or judgments on significant matters or risk factors that relate to the engagement for that entity; or
- is primarily responsible for the engagement work in respect of a significant affiliate, division or function of the entity.

Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognised stock exchange, or are marketed under the regulations of a recognised stock exchange or other equivalent body. This includes any company in which the public can trade shares on the open market, such as those listed on the London Stock Exchange (including those admitted to trading on the Alternative Investments market), ISDX Markets and the Irish Stock Exchange (including those admitted to trade on the Irish Enterprise Securities Market). It does not include entities whose quoted or listed shares, stock or debt are in substance not freely transferable or cannot be traded freely by the public or the entity.

Other public interest assurance engagement – an assurance engagement, other than an *audit engagement*, undertaken in compliance with performance standards issued by the FRC.

Person in a position to influence the conduct or outcome of the engagement

For an audit engagement and for an other public interest assurance engagement other than an investment circular reporting engagement:

- (a) each member of the engagement team and persons who provide engagement quality control review for the engagement;
- (b) any other natural person whose services are placed at the disposal or under the control of the firm and who is involved in the audit or other public interest assurance engagement), including for example any individual who is, or whose services are provided by, any external expert of the firm;
- (c) any person in the firm with supervisory, management or other oversight responsibility over:
 - (i) the engagement or the engagement partner or other key partners involved in the engagement; or

- (ii) the conduct of audit or other public interest assurance engagements performed by the firm.

This includes each partner, principal, shareholder and other person in the firm:

- a. at each level of firm management, supervision or oversight relating to the audit or other public interest assurance engagement, up to and including individuals who have ultimate responsibility for the management or governance of the firm⁷;
- b. who is in a position to prepare, review or otherwise influence the performance appraisal and/or remuneration of any individual defined in (a), (b), (c)(i) and (c)(ii); and
- (d) any other person within the firm or a network firm who, due to any other circumstances, is in a position to influence the conduct or outcome of the audit or other public interest assurance engagement, including for example: those who are in such a position as a result of:
 - (i) their professional or personal relationships with the engagement partner or other key members of the engagement team; or
 - (ii) the scope and nature of their responsibilities within the firm's network.

It does not include any independent non-executive individuals on a supervisory or equivalent board.

For an investment circular reporting engagement:

- (a) each member of the engagement team and persons who provide engagement quality control review for the engagement;
- (b) any other natural person whose services are placed at the disposal or under the control of the firm and who is directly involved in the engagement), including for example any individual who is, or whose services are provided by, any external expert of the firm; and
- (c) any other person within the firm or a network firm, with actual knowledge of the engagement, who, due to any other circumstances, is in a position to influence the conduct or outcome of the engagement, including for example: those with actual knowledge of the engagement who are in such a position as a result of:
 - (i) their professional or personal relationships with the engagement partner or other key members of the engagement team; or
 - (ii) the scope and nature of their responsibilities within the firm's network.

It does not include any independent non-executive individuals on a supervisory or equivalent board. [ESRA 1.16]

“persons closely associated” with another person are defined in the EU Regulation 596/2014⁸ as:

⁷ Senior or managing partner, chief executive or equivalent, and other members of the firm's management and supervisory bodies.

⁸ The EU Audit Directive defines a ‘person closely associated’ as within the meaning in Commission Directive 2004/72/EC. However, Regulation 596/2014 on market abuse (market

- (a) a spouse, or a partner considered to be equivalent to a spouse in accordance with national law;
- (b) a dependent child, in accordance with national law;
- (c) a relative who has shared the same household for at least one year on the date of the transaction concerned; or
- (d) a legal person, trust or partnership, the managerial responsibilities of which are discharged by a person discharging managerial responsibilities or by a person referred to in point (a), (b) or (c), which is directly or indirectly controlled by such a person, which is set up for the benefit of such a person, or the economic interests of which are substantially equivalent to those of such a person;

Public interest entity – These are defined in Article 2.13 of the EU Audit Directive as:

- (a) entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;
- (b) credit institutions as defined in point 1 of Article 3(1) of Directive 2013/36/EU of the European Parliament and of the Council⁹, other than those referred to in Article 2 of that Directive;
- (c) insurance undertakings within the meaning of Article 2(1) of or;
- (d) entities designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.

No other entities have been specifically designated in law in the UK and Ireland as ‘public interest entities’.

Statutory audit – An audit performed pursuant to the EU Audit Directive and Regulation or otherwise designated by national law as a statutory audit.

Statutory auditor¹⁰ – A natural person with the appropriate approval to carry out statutory audits.

Subject matter – the underlying object of the engagement, the outcome of the evaluation or measurement of which against the criteria comprises the subject matter information.

Subject matter varies widely in assurance engagements but in public interest assurance engagements is often one or more financial or non-financial

abuse regulation) repeals, inter alia, Commission Directive 2004/72/EC with effect from 3 July 2016.

⁹ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176., 27.6.2013., p.338)

¹⁰ In the EU Audit Directive and Regulation the term ‘statutory auditor’ is used in the context of a natural person. In the UK Companies Act 2006, the term ‘statutory auditor’ is used for both natural and legal persons.

aspects of an entity of interest to the intended users of the assurance report. The entity responsible for the subject matter is therefore usually the entity whose underlying subject matter is being addressed in such engagements. In some engagements, there can be more than one entity responsible for the subject matter.

Subject matter information – the outcome of the evaluation or measurement of the subject matter against the criteria,

The entity responsible for the subject matter information is therefore the entity responsible for the measurement or evaluation of the subject matter against the criteria. In many attestation assurance engagements, this is the same as the entity responsible for the subject matter (as is also the case in an audit engagement). However, there may be a separate evaluator or measurer of the subject matter. In direct assurance engagements (such as the CASS audit), the evaluation or measurement is performed by the assurance practitioner. When the entity responsible for the subject matter information is the assurance practitioner, it is not an entity relevant to the engagement. In some engagements, there can be more than one entity responsible for the subject matter information.

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 partners¹¹ and all staff shall behave with integrity and objectivity in all professional and business activities and relationships. [ES 1.6, ESRA 1.6]

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 supersedes all commercial interests of the firm.

1.1 – 1.26
Compliance with Ethical Requirements

1.2 The firm shall establish and apply confidential whistle-blowing policies and procedures across the firm which enable people to report, without fear, concerns about the firm's commitment to quality work and professional judgement and values in a way that properly takes the public interest into consideration.

1.12(h)

Independence

Overarching Principle

2. In relation to each audit or other public interest assurance engagement, the firm, and each person in a position to influence the conduct or outcome of the engagement, shall ensure (in the case of an individual, insofar as they are able to do so) that the firm and those individuals are free from conditions and relationships which would make it probable that an objective, reasonable and informed third party would conclude compromise the independence of the firm or those individuals. [ES 1.6, ESRA 1.6]

¹¹ The term 'partner' includes any individual with authority to bind the firm with respect to the performance of a professional services engagement.

Supporting Ethical Provisions

2.1 Each person in a position to influence the conduct or outcome of an audit or other public interest assurance engagement, shall ensure (in the case of an individual, insofar as they are able to do so) that the independence of the firm and of those individuals is not compromised with respect to the entity(ies) relevant to the engagement or with respect to any entity responsible for evaluating or measuring the subject matter information. This includes not being involved in the decision-taking of such entity(ies). Independence shall not be compromised:

- (a) In the case of an audit, at least during both the period covered by the financial statements to be audited and the period during which the audit is carried out;
- (b) In the case of an other public interest assurance engagement, at least during the period over which, or at the time as at which, the subject matter is measured or evaluated in connection with the engagement and the period during which the engagement is carried out. [AD 22.1]

2.2 The firm shall take all reasonable steps to ensure that, when carrying out an audit or other public interest assurance engagement, the integrity, objectivity and independence of the firm and each person in a position to influence the conduct or outcome of the engagement are not affected by any existing or potential conflict of interest or any business or other direct or indirect relationship involving:

- (i) the firm carrying out the audit or other public interest assurance engagement; and where appropriate members of its network:
- (ii) the firm's partners, principals, shareholders, managers, auditors, employees, any other natural persons whose services are placed at the disposal or under the control of the firm; or
- (iii) any person directly or indirectly linked to the firm by control. [AD 22.1]

1.27 – 1.42

Identification and Assessment of Threats

1.43 – 1.50

Identification and Assessment of Safeguards

1.51 – 1.53

Other Firms

2.3 The firm shall not accept, continue or carry out an audit or other public interest assurance engagement:

- (i) if there is any threat of self-review, self-interest, advocacy, familiarity or intimidation created by financial, personal, business, employment or other relationships between:
 - (a) the firm, its network, and any person in a position to influence the conduct or outcome of the engagement, and
 - (b) the audited entity (or the entity whose subject matter is being measured or evaluated, and any

1.27 – 1.42

Identification and Assessment of Threats

1.43 – 1.50

Identification and Assessment of Safeguards

<p>entity which is responsible for such measurement or evaluation, in connection with a public interest assurance engagement); or</p> <p>(ii) unless required by law to do so, if any other condition or relationship exists;</p> <p>which would compromise the independence of the firm or any person in a position to influence the conduct or outcome of the engagement. [AD 22.1]</p>	<p>1.51 – 1.53</p> <p>Other Firms</p> <p>1.55 – 1.58</p> <p>Overall Conclusion</p> <p>Section 2 – Financial, Business, Employment and Personal Relationships</p> <p>Section 3 – Long Association with Engagements</p>
<p>2.4 For a group audit or other public interest assurance group engagement, the firm’s independence would be compromised if the independence of any network firm (whether or not involved in the engagement), or of any third party firm whose work is used in the conduct of the engagement, would be compromised with respect to the engagement, in accordance with: in the case of a network firm whose work is used in the conduct of the engagement, the overarching principles, supporting ethical provisions and requirements established in this Ethical Standard as applicable to the group auditor; and, in the case of any other network or third party firm, the extant version of the IESBA Code. [ES 1.58, 1.61, ESRA 1.66]</p>	<p>1.51 – 1.53</p> <p>Other Firms</p> <p>1.59 – 1.69</p> <p>Communication with Those Charged with Governance</p>
<p>2.5 In evaluating whether or not a condition or relationship would compromise independence, it is the responsibility of (i) the firm, and (ii) 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 of those individuals.</p>	<p>1.6 – 1.8</p> <p>Compliance with Ethical requirements</p>
<p>2.6 All partners and all staff of the firm and all other persons in a position to influence the conduct or outcome of the engagement shall remain alert to conditions or relationships which could impair the independence of the firm or any of those individuals.</p>	<p>1.27 – 1.42</p> <p>Identification and Assessment of Threats</p>
<p>2.7 All partners and staff of the firm and all other persons in a position to influence the conduct or outcome of the engagement who become aware of any condition or relationship which could impair the independence of the firm or any of those individuals 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</p>	

responsibility for the management of the firm's audit and other public interest assurance business, at the earliest opportunity. [ES 1.31, ESRA 1.45]

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 person in a position to influence the conduct or outcome of the engagement would be compromised and, if so, to apply sufficient safeguards, to eliminate the condition or relationship or to withdraw from the engagement.

1.43 – 1.50
Identification and Assessment of Safeguards
1.55 – 1.58
Overall Conclusion

2.9 In relation to an audit or other public interest assurance engagement, a firm shall not:

- agree a basis for determining fees, or Section 4 (4.1 – 4.48)
- have remuneration and evaluation policies for partners and staff, Section 4 (4.49 – 4.53)

which would compromise the independence of the firm or of any person in a position to influence the conduct or outcome of the engagement.

2.10 In relation to an audit or other public interest assurance engagement, the firm, its partners and staff and any other person in a position to influence the conduct or outcome of an engagement, and *persons closely associated* with them, shall not provide or accept gifts and hospitality unless it is probable that an objective, reasonable and informed third party would consider the value thereof to be trivial or inconsequential.

Section 4 (4.54 – 4.58)

2.11 The firm shall not accept or continue an audit or other public interest assurance engagement for an entity, unless required by law to do so, where litigation in relation to any engagement between the firm or its partners 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 of any person in a position to influence the conduct or outcome of the engagement .

Section 4 (4.59 – 4.61)

2.12 The firm shall not provide any non-audit / additional services to an entity relevant to an audit or other public interest assurance engagement by the firm, where such provision would compromise the independence of the firm or of any person in a position to influence the conduct or outcome of the engagement .

Section 5

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 1.23 and 1.24 of Section 1 in Part B of this Ethical Standard.

Part B

Section 1 – General Requirements and Guidance

Compliance with Ethical Requirements

- 1.1 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 audit or other public interest assurance engagement in any way which jeopardises the integrity, objectivity or independence of the firm or persons in a position to influence the conduct or outcome of the engagement; [AD 24a.1(a)]**
- 1.2 The firm shall establish appropriate and effective organisational and administrative arrangements to prevent, identify, eliminate or manage and disclose any threats to its independence; [AD 24a.1(e)]**
- 1.3 The firm shall also establish appropriate and effective organisational and administrative arrangements 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)]**
- 1.4 The firm shall take into consideration the scale and complexity of its activities when complying with the requirements set out in paragraphs 1.1 to 1.3. [AD 24a.2]**
- 1.5 The firm shall be able to demonstrate to the [competent authority¹²] that the policies and procedures designed to achieve such compliance are appropriate given the scale and complexity of activities of the firm. [AD 24a.2]**
- 1.6 The firm and persons required to meet the outcomes of the overarching principles and supporting ethical provisions in this Ethical Standard shall 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 the outcomes of the overarching principles and supporting ethical provisions;**
 - identified and reported relevant conditions and circumstances that threaten meeting the outcomes of the overarching principles and supporting ethical provisions;**
 - established and operated effective safeguards;**

¹² Identity of the 'competent authority' to be stated in the final standard.

- **evaluated the threats and safeguards appropriately;**
- **taken any additional steps that are necessary to meet the ethical outcomes required by the overarching principles and supporting ethical provisions.** [New]

1.7 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 audit and other public interest assurance engagements vary widely and meeting these ethical outcomes is paramount. Compliance with the specific requirements may not be sufficient to do so.

1.8 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.

1.9 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 and each person in a position to influence the conduct or outcome of the audit or other public interest assurance engagement.^{13, 14} [ES 1.18]

1.10 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 compliance with the overarching principles and supporting ethical provisions for audit and other public interest assurance engagements

¹³ Monitoring of compliance with ethical requirements will often be performed as part of a broader quality control process. ISQC (UK & Ireland) 1 '*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.

¹⁴ [In addition, UK legislation provides that each of the Recognised Supervisory Bodies must have adequate rules and practices to ensure that the audit firm has arrangements to prevent any person from being able to exert any influence over the way in which a *statutory audit* is conducted in circumstances in which that influence would be likely to affect the independence or integrity of the audit].

by all parts of the firm, including those parts that are not involved in providing audit and other public interest assurance services. [ES 1.20]

1.11 **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; dedicating appropriate resources and leadership to compliance with supporting ethical provision 1.1; and making 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.**
[New]

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

- (a) requirements for partners, staff, and any other persons in a position to influence the conduct or outcome of an engagement, to report where applicable in relation to an entity relevant to an audit or other public interest assurance 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, staff and any other persons in a position to influence the conduct or outcome of an audit or other public interest assurance engagement, addressing, for example:
 - financial interests in entities relevant to an audit or other public interest assurance engagement by the firm;
 - economic dependence on entities relevant to an audit or other public interest assurance engagement by the firm;
 - the performance of non-audit / additional services;
 - engagement partner rotation;
- (c) identification of the entities which partners, staff, and other persons in a position to influence the conduct or outcome of audit or other public interest assurance engagements, and, where applicable, *persons closely associated* with them, need to be independent from;
- (d) 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 staff to communicate to senior levels within the firm any issue of integrity, objectivity or independence that concerns them; this includes establishing clear communication channels open to staff, encouraging staff to use these channels and ensuring that staff who use these channels are not unfairly discriminated against and are subject to disciplinary proceedings as a result. [ES 1.21]
- 1.13 **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 non-executive directors, where applicable.**
- 1.14 **Save where the circumstances contemplated in paragraph 1.21 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, its compliance with this Ethical Standard, and the effectiveness of its communication to partners, staff and other persons in a position to influence the conduct or outcome of an audit or other public interest assurance engagement on these matters within the firm; and**
 - (b) **providing related guidance to individual partners with a view to achieving a consistent approach to the application of this Ethical Standard. [ES 1.22, ESRA 1.22]**
- 1.15 **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 followed¹⁵. [New]**
- 1.16 The Ethics Partner is an individual with seniority and authority at leadership levels within the firm, possessing relevant experience, and whose decisions and advice 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.
- 1.17 **The Ethics Partner shall not undertake another role within the firm which conflicts with their responsibilities as Ethics Partner. [New]**
- 1.18 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. [ES 1.23]

¹⁵ ISQC (UK and Ireland) 1, paragraph 43, requires firms to establish policies and procedures for dealing with and resolving differences of opinion with those consulted.

- 1.19 In the case of firms that audit or provide other public interest assurance services to *public interest entities* or other *listed entities*, the Ethics Partner has direct access to the firm's independent non-executives where such roles are introduced in the firm¹⁶ or, alternatively, to the firm's most senior governance body. [ES 1.24]
- 1.20 In assessing the effectiveness of the firm's communication of its policies and procedures relating to integrity, objectivity and independence, Ethics Partners consider whether ethics are covered properly in 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 position reached. Ethics Partners are 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. [ES 1.25]
- 1.21 In firms with three or fewer partners who are 'responsible individuals'¹⁷, 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. [ES 1.26]
- 1.22 To be able to discharge his or her responsibilities, the Ethics Partner is provided with sufficient staff support and other resources (the Ethics Function), commensurate with the size of the firm. Alternative arrangements are 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 establishes 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

¹⁶ 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.

¹⁷ 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.

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. [ES 1.27]

1.23 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 from the engagement. [ES 1.28]

1.24 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 persons in a position to influence the conduct or outcome of an engagement 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 person in a position to influence the conduct or outcome of an engagement 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 person or removing him or her from the engagement team or from otherwise being in a position to influence the conduct or outcome of the engagement); and
- (d) the actions taken and the rationale for them are documented. [ES 1.29]

1.25 Supporting ethical provision 2.1 requires that the firm and each person in a position to influence the conduct or outcome of an audit or other public interest assurance engagement is not involved in the decision-taking of an entity relevant to the engagement. Paragraph 5.56 of Section 5 of Part B this Ethical Standard requires 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.

1.26 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 are not made by the firm or a person in a position to influence the conduct or outcome of an audit or other public interest assurance engagement 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. [ES 1.34]

Services that involve taking "any part in the management or decision-making of the entity" include, for example, working capital management, providing financial information, business process optimisation, cash management, transfer pricing and, creating supply chain efficiency and the like.

Identification and Assessment of Threats

1.27 The engagement partner identifies and assesses the circumstances which could adversely affect the integrity or objectivity of the firm or of persons in a position to influence the conduct or outcome of the engagement ('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. [ES 1.30]

1.28 **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 and persons in a position to influence the conduct or outcome of the engagement and the ability to continue with the audit or other public interest assurance 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

- 1.29 When complying with ethical provision 2.1, threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of an audit or other public interest assurance engagement 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 cumulative¹⁸ basis and the action taken is documented. If the engagement partner is personally involved, 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 material to the issue. [ES 1.32]
- 1.30 The principal types of threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the engagement are:
- ***self-interest threat***

A self-interest threat arises when any of the firm, its partners, staff or other persons in a position to influence the conduct or outcome of the engagement, has financial or other interests which might cause any of them to be reluctant to take actions that would be adverse to such interests of the firm or any individual in a position to influence the conduct or outcome of the audit or other public interest assurance engagement (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).
 - ***self-review threat***

A self-review threat arises when the results of an engagement to provide non-audit / additional services, or where the subject matter of such an engagement, performed by the firm, the engagement team or by others within the firm are addressed in the engagement or reflected in the amounts included or disclosed in the financial statements or otherwise in the subject matter information in an other public interest assurance engagement (for example, 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 audit or other public interest assurance 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 engagement to provide non-audit / additional services, the firm 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.

¹⁸ 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.

In relation to an investment circular reporting engagement, there is 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 completely 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. [ESRA 1.32]

- ***management threat***

In addition to the risk of being involved in making decisions that are the responsibility of management, a management threat can also arise when the firm undertakes an engagement to provide non-audit / additional services in relation to which management are required to make judgments and take decisions based on that work (for example, the design, selection and implementation of a financial information technology system). In such work, the firm may become closely aligned with the views and interests of management and the integrity, objectivity and independence of the firm, its partners and staff may be, or may be perceived to be compromised.

In relation to an investment circular reporting engagement, a management threat arises 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). [ESRA 1.35]

- ***advocacy threat***

An advocacy threat arises when the firm undertakes work that involves acting as an advocate for an entity relevant to an audit or other public interest assurance engagement by the firm, 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 persons in a position to influence the conduct or outcome of the engagement.

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

A familiarity (or trust) threat arises when the firm or a person in a position to influence the conduct or outcome of the engagement is predisposed to accept, or are insufficiently questioning of, the point of view of an entity relevant to the engagement (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 person in a position to influence the conduct or outcome of the engagement is influenced by fear or threats (for example, where the persons conducting the engagement encounter an aggressive 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 audit or other public interest assurance engagement by the firm, but encounters an aggressive or dominating individual, there may be a self-interest threat as well as an intimidation threat. Furthermore, relationships with parties connected with the entity (such as an affiliate) may give rise to similar threats. [ES 1.35]

- 1.31 Threats to the integrity and objectivity of the firm and persons in a position to influence the conduct or outcome of an engagement, including threats that could compromise independence, may arise where the firm is appointed to a non-audit / additional service engagement for an entity not relevant to an audit or other public interest assurance engagement by the firm, but where an entity that is relevant to an audit or other public interest assurance engagement by the firm makes this decision. In such cases, even if the entity not relevant to an audit or other public interest assurance engagement by the firm pays the fee for the non-audit / additional service engagement, the firm considers the implication of the threats (especially the self-interest threat) that arise from the appointment. [ES 1.36]
- 1.32 Similarly threats may arise where the firm or any person in a position to influence the conduct or outcome of the engagement has a relationship with any connected party of the entity. Where any member of the engagement team is aware of such relationships, an assessment of the threats and available safeguards is made. [ES 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 persons in a position to influence the conduct or outcome of the engagement on an individual and cumulative¹⁰ basis, including any threats that may compromise independence:**
- (a) when considering whether to accept or retain an audit or other public interest assurance engagement;**
 - (b) when planning the engagement;**
 - (c) when forming an opinion and signing the report on the financial statements or on other subject matter information;¹⁹**

¹⁹ 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.

- (d) when considering whether to accept or retain an engagement to provide non-audit / additional services to an entity relevant to an audit or other public interest assurance engagement by the firm; and**
- (e) when potential threats are reported to him or her. [ES 1.38, ESRA 1.50]**

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 audit or other public interest assurance engagement. That assessment is reviewed and updated at the planning stage of each engagement. If consideration of whether to accept or 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 on 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 impair 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 accept an engagement 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. [ES 1.39]

1.35 When identifying and assessing threats to the integrity and objectivity including any that may compromise independence of the firm or persons in a position to influence the conduct or outcome of the engagement, the engagement partner takes into account current relationships with the entity (including non-audit / additional service engagements and known relationships with connected parties of the entity) and with other parties in certain circumstances (see paragraph 1.36), those that existed prior to the current engagement and any known to be in prospect following the current engagement. This is because those prior and subsequent relationships may be perceived as likely to influence the firm or persons in a position to influence the conduct or outcome of the engagement in the performance of the audit or other public interest assurance engagement or as otherwise compromising the integrity, objectivity or independence of the firm or persons in a position to influence the conduct or outcome of the 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 subsequent to the balance sheet date of the most recent audited financial statements²⁰ [ES 1.40, ESRA 1.52]

1.36 Threats to the integrity or objectivity of the firm and persons in a position to influence the conduct or outcome of the engagement including those that may compromise independence, may 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 audit or other public interest assurance 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.

²⁰ 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.

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. [ES 1.41]

- 1.37 Where the entity relevant to an audit or other public interest assurance engagement by the firm or a third party calls into question the integrity, objectivity or independence of the audit firm in relation to a particular entity, the Ethics Partner carries out such investigations as may be appropriate and determines what action, if any, is needed. [ES 1.42]

Investment Circular Reporting Engagements

- 1.38 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. 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 circular²¹. 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 both these parties, applying the alternative procedures set out in paragraph 1.39 as necessary. [ESRA 1.43]

- 1.39 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 service 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 enquiries²² that are practical in the time available into the relationships and other service 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 engagement entity that a consideration of all known threats has been undertaken and, where appropriate, safeguards applied, but this does not constitute a full evaluation

²¹ 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.

²² 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.

of all relationships and other services provided to the non-audit entity relevant to the engagement. [ESRA 1.44]

- 1.40 In addition to considering independence in the context of the entity(ies) relevant to the engagement, the reporting accountant also considers relationships with other parties who are connected with the investment circular. These parties will include the sponsor or nominated advisor, other parties 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.²³ 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. [ESRA 1.47]
- 1.41 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 [and are not material to an entity(ies) relevant to the engagement]. These relationships will not generally give rise to a significant threat to the reporting accountant's integrity or objectivity. [ESRA 1.48]
- 1.42 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(ies) 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. [ESRA 1.49]

Identification and Assessment of Safeguards

- 1.43 **If the engagement partner identifies threats to the integrity or objectivity of the firm or persons in a position to influence the conduct or outcome**

²³ 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.

of the engagement, including any that may impair 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. [ES 1.43, ESRA 1.55]

1.44 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. [ES 1.44]

1.45 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 persons in a position to influence the conduct or outcome of the engagement. 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 circumstances where this is not possible, the firm either does not accept or withdraws from the audit or other public interest assurance 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 engagement to provide the non-audit / additional service. [ES 1.45, ESRA 1.57]

1.46 This Ethical Standard contains certain additional requirements or prohibitions that apply only in the case of audit or other public interest assurance engagement for *public interest entities* or for *listed entities* or *in both cases*:

- Public interest entities only: paragraphs 1.73, 2.38(b)(i), 3.9, 3.17, 3.18, 4.31, 5.56, 5.57, 5.58, 5.59, 5.60, 5.61
- Listed entities only (including such entities that are PIEs): paragraphs 3.10, 5.66, 5.88(a), 5.95(a), 5.108, 5.119(a), 5.126, 5.167, 5.174(a)
- Listed entities and public interest entities: paragraphs 1.65, 3.19, 3.20, 4.22, 4.35, 4.40, 5.26, 5.46(b)

These additional requirements also apply where regulation or legislation requires that the audit or other public interest assurance engagement for an entity is conducted in accordance with the standards or ethical requirements that are applicable to the audit or other public interest assurance service for *public interest entities* or other *listed entities*. [ES 1.46]

1.47 **The firm shall establish policies and procedures which set out the circumstances in which those additional requirements listed in paragraph 1.46 that apply to *public interest entities* or to *listed entities* or both are applied to other audit and public interest assurance 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 auditor or assurance practitioner shall communicate that fact to those charged with governance and, in complying with paragraph 28(c) of ISA (UK and Ireland) 700, shall indicate that the requirements of this Ethical Standard applicable to *public interest entities* or *listed entities* or both were relevant to the engagement. [ES 1.47]**

1.48 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 audit or other public interest assurance engagements of certain large private sector entities. [ES 1.48]

- 1.49 **The engagement partner shall not accept or shall not continue an audit or other public interest assurance engagement if he or she concludes that any threats to the integrity or objectivity of the firm or persons in a position to influence the conduct or outcome of the engagement cannot be reduced to a level where independence would not be compromised.** [ES 1.49, ESRA 1.58]
- 1.50 Where an objective, reasonable and informed third party would regard ceasing to act as the auditor or provider of an other public interest assurance 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. [ES 1.50, ESRA 1.59]

Other Firms Involved in Group Audit or Other Public Interest Assurance Engagements

- 1.51 In order to use the work of another firm (including network firms) for the purpose of a group audit or other public interest assurance engagement, the lead firm for the group engagement has to be satisfied that such another firm is independent of the group in accordance with supporting ethical provision 2.4 of this Ethical Standard.
- 1.52 The group engagement partner obtains appropriate evidence²⁴ that all network firms (whether or not involved in the group engagement), and third party firms whose work is used in the conduct of the group engagement, are independent of the group in accordance with supporting ethical provision 2.4. If the group engagement partner is not able to obtain such evidence, or obtains evidence that the other firm does not meet the relevant independence requirements, the group engagement team cannot use the work of that other firm for the purpose of the group engagement. Work for the purpose of the group engagement may be undertaken, where possible, by partners and staff from the lead firm or by the use of another firm which is independent of the group as required. [ES 1.59]
- 1.53 In the case of a *public interest entity* or an other *listed entity*, the group engagement partner establishes that the company has communicated its policy²⁵ on the engagement of firms to supply non-audit / additional services

²⁴ For an audit, ISA (UK and Ireland) 600 '*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.

²⁵ 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.

to its affiliates and obtains confirmation that the other firms will comply with this policy. [ES 1.60]

Engagement Quality Control Review

- 1.54 Requirements for engagement quality control review are established in ISQC (UK and Ireland) 1.

Overall Conclusion

- 1.55 **At the end of the audit or other public interest assurance engagement process, when forming an opinion on the financial statements, or on the subject matter information or subject matter in the case of an other public interest assurance engagement, 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 report and the firm shall resign as auditor or provider of the public interest assurance engagement and withdraw from the engagement.** [ES 1.54, ESRA 1.63]
- 1.56 In addition to assessing individual threats to integrity or objectivity including any that could impair independence of the firm or persons in a position to influence the conduct or outcome of the engagement, the engagement partner assesses the cumulative impact of all the threats identified on the audit or other public interest assurance engagement 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. [ES 1.55]
- 1.57 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 properly addressed in accordance with this Ethical Standard, or if there is a disagreement between the engagement partner and the engagement quality control reviewer, he or she consults the Ethics Partner / Function. [ES 1.56]
- 1.58 In concluding on compliance with the requirements for integrity, objectivity and independence, 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 in as the responsibility of the engagement partner in this Ethical Standard. [ES 1.57]

Communication with Those Charged With Governance

- 1.59 **The engagement partner shall ensure that those charged with governance of the entity relevant to an audit or other public interest assurance engagement by the firm, and 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 persons in a position to influence the conduct or outcome of the engagement. [ES 1.63, ESRA 1.68]

- 1.60 **For an investment circular reporting engagement for an entity that is not a *public interest entity* or an other *listed entity*, the facts and matters communicated shall include as a minimum the information required to be communicated by paragraph 1.65.** [New]
- 1.61 The audit committee, where one exists, is usually responsible for oversight of the relationship between the firm and the entity relevant to the engagement and of the conduct and outcome of the engagement process. It therefore has a particular interest in being informed about the firm's ability to express an objective opinion on the financial statements, or on the other subject matter information or subject matter in the case of an other public interest assurance 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.²⁶. [ES 1.64]
- 1.62 The aim of these communications is to ensure full and fair disclosure by the firm to those charged with governance of the entity(ies) relevant to the engagement on matters in which they have an interest. These will generally include the key elements of the engagement partner's consideration of integrity, objectivity and independence, such as:
- 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. [ES 1.65]
- 1.63 If applicable (e.g. for an investment circular reporting engagement), communications are made also to those from whom, in accordance with the engagement letter, the firm takes instructions of 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 persons in a position to influence the conduct or outcome of the engagement. In other cases, however, the parties to the engagement letter (other than the entity(ies) 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

²⁶ 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.

those from whom, in accordance with the engagement letter, the firm takes instructions. [ESRA 1.70, 1.71]

- 1.64 Communications between the firm and those charged with the governance of the firm entity 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 an engagement to provide non-audit / additional services. [ES 1.66]

Additional Requirements Related to *Public Interest Entities* and to other *Listed Entities*

- 1.65 **In the case of *public interest entities*, and *listed entities*, relevant to an audit or other public interest assurance engagement by the firm, the engagement partner shall ensure that the audit committee, and any other persons or entities the firm is instructed to advise, 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 persons in a position to influence the conduct or outcome of the engagement. This shall have regard to relationships with the entity, its directors and senior management, and its affiliates 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 persons in a position to influence the conduct or outcome of the engagement 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 persons in a position to influence the conduct or outcome of the engagement are independent;**
- (d) **details of any inconsistencies between this Ethical Standard and the policy of the entity(ies) relevant to the engagement for the supply of non-audit / additional services by the firm and any apparent breach of that policy.**
- (e) **an opportunity to discuss independence issues. [ES 1.67]**

For an investment circular reporting engagement, the information communicated shall include:

- (i) **disclosure in writing 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;**
 - **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 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;**
- (ii) **written confirmation that, where relevant, the circumstances contemplated in paragraph 1.39 exist and 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. [ESRA 1.73]**
- 1.66 The most appropriate time for these final written confirmations of independence is usually at the conclusion of the audit. [ES 1.68]
- 1.67 The disclosure in writing of all relationships with the engagement entity, 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 persons in a position to influence the conduct or outcome of the engagement and the related safeguards that are in place. [ES 1.69]
- 1.68 For an audit engagement, the audit 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 committee²⁷. Separately, the auditor provides information on any contingent fee arrangements²⁸, 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. [ES 1.70]
- 1.69 The written confirmation that the firm and persons in a position to influence the conduct or outcome of the engagement are 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 persons in a position to influence the conduct or outcome of the engagement are 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 persons in a position to influence the conduct or outcome of the engagement may be compromised (including instances where the group 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. [ES 1.71]

Documentation

- 1.70 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 persons in a position to influence the conduct or outcome of the engagement as well as the safeguards applied to mitigate those threats. [AD 22.3]
- 1.71 The engagement partner shall ensure that his or her consideration of the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the engagement is appropriately documented on a timely basis. [ES 1.72, ESRA 1.77]
- 1.72 Before accepting or continuing an engagement for an audit or other public interest assurance 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 and independence and the safeguards applied to mitigate those threats;
 - whether it has the competent employees, time and resources needed in order to carry out the audit or other public interest assurance engagement in an appropriate manner;
 - whether, in the case of an audit firm that is not a sole practitioner, the *key audit partner* is approved as *statutory auditor*. [AD 22b.1)
- 1.73 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 1.72 above, the following:
- (a) ~~whether he, she or it~~ complies with the requirements of Articles 4²⁹ and 5³⁰ of ~~this~~ the EU Audit Regulation;
 - (b) whether the conditions of Article 17³¹ of ~~this~~ the EU Audit Regulation are complied with;
 - (c) ~~without prejudice to Directive 2005/60/EC~~, the integrity of the members of the supervisory, administrative and management bodies of the *public-interest entity*. [AR 6.1]
- 1.74 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 persons in a position to influence the conduct or outcome of the engagement was properly performed and, for *public interest entities* and other

²⁹ See Section 4, paragraphs 4.6, 4.7 and 4.31 – 4.33, of this Ethical Standard.

³⁰ See Section 5, paragraphs 5.56 – 5.61, of this Ethical Standard.

³¹ See Section 3, paragraphs 3.9, 3.17, 3.18, of this Ethical Standard.

listed entities and where otherwise applicable, provides the basis for review by the engagement quality control reviewer. [ES 1.73]

1.75 Matters to be documented³² 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 the entity(ies) 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;
- 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, on an individual and cumulative basis, and safeguards; and
- communication with those charged with governance and, where applicable, any other persons or entities the firm is instructed to advise. [ES 1.74, ESRA 1.79]

Effective Date

1.76 This revised Ethical Standard becomes effective on xxxxxx.

³² The necessary working papers can be combined with those prepared pursuant to paragraph 24 of ISA (UK and Ireland) 220 *‘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.”

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 (including an equity instrument or other security, debenture, loan or other debt 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. [ES 2.5]
- 2.2 Financial interests may be:
- (a) held directly (such as through direct ownership or by way of a direct beneficial interest), rather than through intermediaries (a 'direct financial interest'); or
 - (b) held indirectly through intermediaries, such as a diversified collective investment scheme, including life insurance, an open ended investment company or a pension fund or scheme (an 'indirect financial interest'). [ES 2.6]
- 2.3 **A firm, each partner in the firm, and each other *person in a position to influence the conduct or outcome of any audit or other public interest assurance engagement* of the firm and any *persons closely associated with any such partner or other person*, shall not have a material direct financial interest in, or engage in any transaction in, any financial instrument of any entity relevant to such an engagement of the firm. [AD 22.2]**
- 2.4 **Persons and firms referred to in paragraph 2.3 shall not participate in or otherwise be in a position to influence the conduct or outcome of any audit or other public interest assurance engagement of the firm if they have:**
- (a) a direct financial interest; or**
 - (b) an indirect financial interest that is material to the firm or to the individual or to the intermediary;**
- in any entity relevant to the engagement or in any entity that is an affiliate of, or otherwise related to, such an entity. [AD22.4] [ES 2.7, ESRA, 2.5]**
- 2.5 The requirements in paragraphs 2.3 and 2.4 have been established because threats to integrity, objectivity and independence in relation to audit and other public interest assurance engagements of the firm, where the firm or other persons have direct or indirect financial interests in entities relevant to such engagements 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. [ES 2.8]

2.6 Where a *person closely associated* with a partner in the firm other than a *key audit partner*, or with another person referred to in paragraph 2.3, who is (in either case) not in a position to influence the conduct or outcome of any audit or other public interest assurance 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 2.3 has close working contacts with the engagement team, the Ethics Partner/Function considers whether any safeguards need to be put in place. [ES 2.10]

2.7 Where financial interests in a diversified collective investment scheme (such as an authorised unit or investment trust or an open ended investment company) or an equivalent investment vehicle or an affiliate of such an entity are held by a partner in the firm other than a *key audit partner* or by another person described in paragraph 2.3 or by a person closely associated with such a partner or other person, and: that entity is not audited by the firm; and that partner or other person is not in a position to influence the conduct or outcome of an other public interest assurance engagement such interests are to be treated, for the purposes of paragraph 2.4, 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. [ES 2.11]

2.8 For the purposes of paragraphs 2.3 and 2.4, where a partner or other person referred to in paragraph 2.3, or any *person closely associated* with them is a member or shareholder of any entity that is related to an audit or other public interest assurance engagement of the firm, 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. Holding such interests is not permitted in the case of a statutory audit. Disclosure of such interests should be made to those charged with governance of such an entity, in accordance with paragraph 1.59 of Section 1 of this Ethical Standard. [ES 2.12]

2.9 Where one of the financial interests specified in paragraphs 2.3 or 2.4 is held by the firm, a partner or another person referred to in paragraph 2.3, either: the entire financial interest is disposed of; or a sufficient amount of a direct financial interest (in the case of one specified in paragraph 2.3) or of an indirect financial interest (in the case of one specified in paragraph 2.4) is

disposed of so that the remaining interest is no longer material; or, in the case of an individual, that person is removed from any role where they would be a person in a position to influence the conduct or outcome of any audit or other public interest assurance engagement of the firm; or, in the case of a firm, the firm does not accept (or withdraws from) the engagement. [ES 2.13]

- 2.10 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 2.9 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 is normally in a position to influence the conduct or outcome of the engagement that person is excluded from any role that would put them in such a position, for the purposes of the particular investment circular reporting engagement. [ESRA 2.6]
- 2.11 Where a person who is joining the firm or any *person closely associated* with them has any financial interests that they would not be permitted to have in accordance with the requirements in paragraph 2.3, they should:
- (i) Where the person joining will be a *key audit partner* or will otherwise be a person in a position to influence the conduct or outcome of any audit engagement of the firm, dispose of any material direct financial interests in any audited entity of the firm, prior to the person joining the firm;
 - (ii) Dispose of any other financial interests that they would not be permitted to have in accordance with the requirements in paragraph 2.3 immediately when the person joins the firm unless:
 - (a) the financial interests were acquired before the person joined the firm; and
 - (b) the person joining the firm is not able to influence the affairs of any entity relevant to an audit or other public interest assurance engagement in which the interests are held; and
 - (c) 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
 - (d) the financial interests are not held in an entity relevant an audit or other public interest assurance engagement in relation to which the person joining the firm:
 - is in a position to influence the conduct or outcome of the engagement; 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; and
 - (iii) Dispose of any such financial interests not disposed of in accordance with paragraphs 2.11(i) or (ii) as soon as possible after the individual becomes able to make a disposal. The firm ensures that:
 - (a) such financial interests are 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. [ES 2.9]

2.12 Where any financial interest specified in paragraph 2.3 or 2.4 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 1.43, 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. [ES 2.14]

2.13 Where the disposal of a financial interest in accordance with paragraph 2.11 or 2.12 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 person in a position to influence the conduct or outcome of the engagement from any role that would put them in a position to exert such influence on the engagement, or (where continued participation in the engagement is not precluded in accordance with paragraph 2.4) 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. [ES 2.15]

2.14 Where the firm or one of the individuals specified in paragraph 2.3 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 audited entity;

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 the audit or other public interest assurance engagement of 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 insignificant. However, in certain circumstances a firm or individual may nonetheless be precluded from participating in, or being in a position to influence the conduct or outcome of, an audit engagement of the firm (see paragraphs 2.4, 2.9 and 2.10). [ES 2.16]

2.15 Where the firm or one of the individuals specified in paragraph 2.3 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 insignificant. However, in certain circumstances a firm or individual may nonetheless be precluded from participating in, or being in a position to influence the conduct or outcome of, an audit engagement of the firm (see paragraphs 2.4, 2.9 and 2.10).. ES 2.17]

- 2.16 **Where a person in a position to influence the conduct or outcome of an audit or other public interest assurance engagement becomes aware that a close family member holds any financial interest specified in paragraph 2.4, 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. [ES 2.18, ESRA 2.10]**

Financial Interests Held as Trustee

- 2.17 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 person in a position to influence the conduct or outcome of an audit or other public interest assurance engagement, 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 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 2.3. [ES 2.19]
- 2.18 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. [ES 2.20]
- 2.19 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 in a position to influence the conduct or outcome of any audit or other public interest assurance engagement of the firm or a *person closely associated* with them, cannot be held when the firm or relevant person is an identified potential beneficiary of the trust. [ES 2.21]

Financial Interests Held by Firm Pension Schemes

- 2.20 Where the pension scheme of a firm has a financial interest in an entity relevant to an audit or other public interest assurance engagement by the firm, 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 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. [ES 2.22]

Loans and Guarantees

- 2.21 Where firms, persons in a position to influence the conduct or outcome of an audit or other public interest assurance engagement or *persons closely associated* with them:
- (a) accept a loan³³ 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 2.22, 2.23 and 2.24, 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. [ES 2.23]

- 2.22 **Firms, persons in a position to influence the conduct or outcome of an audit or other public interest assurance engagement 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.** [ES 2.24, ESRA 2.15]
- 2.23 **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.** [ES 2.25, ESRA 2.16]

³³ 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 2.28).

- 2.24 **Persons in a position to influence the conduct or outcome of an audit or other public interest assurance engagement 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. [ES 2.26, ESRA 2.17]**
- 2.25 Loans by an entity relevant to an engagement that is a bank or similar institution to a person in a position to influence the conduct or outcome of the engagement, 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 person in a position to influence the conduct or outcome of the engagement 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. [ES 2.27]

Business Relationships

- 2.26 A business relationship between:
- (a) the firm or a person who is in a position to influence the conduct or outcome of the engagement, 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 the auditor's 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 1.39 of Section 1 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, persons in a position to influence the conduct or outcome of the engagement, or *persons closely associated* with them. [ES 2.28, ESRA 2.19]

2.27 Persons or firms referred to in paragraph 2.3 shall not participate in or otherwise influence the conduct or outcome of the engagement if they have had a business or other relationship with any entity relevant to the engagement within the period referred in supporting ethical provision 2.1 that would compromise independence. [AD 22.4]

2.28 Firms, persons in a position to influence the conduct or outcome of the engagement 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**
- **are clearly inconsequential to either party. [ES 2.29, ESRA 2.20]**

2.29 Where a business relationship exists, that is not permitted under paragraph 2.28, 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 person in a position to influence the conduct or outcome of the engagement*: either the relationship is terminated or that person is excluded from any role that would put them in a position to exert such influence on the engagement;
- (c) *a person closely associated with a person in a position to influence the conduct or outcome of the engagement*: either the relationship is terminated or the person in a position to influence the conduct or outcome of the engagement is excluded from any role that would put them in a position to exert such influence on the 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 that would put them in a position to influence the conduct or outcome of the engagement. [ES 2.30]

2.30 Compliance with paragraph 2.28 is not intended to prevent a firm giving advice in accordance with regulatory requirements³⁴ 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

³⁴ Firms providing such services will be authorised either by the Financial Services Authority or by their professional accountancy body acting as a Designated Professional Body.

where it gives rise to commission or similar payments by the entity to the firm and assesses whether any safeguards are required. [ES 2.31]

2.31 **Where a person in a position to influence the conduct or outcome of the engagement becomes aware that a close family member has entered into one of the business relationships specified in paragraph 2.26, 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.** [ES 2.32, ESRA 2.22]

2.32 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 persons in a position to influence the conduct or outcome of the engagement, 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
- 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 persons in a position to influence the conduct or outcome of the engagement, to obtain their views on the matter. [ES 2.33]

2.33 Where there are doubts about whether a relationship would compromise independence, then the relationship is not clearly inconsequential. [ES 2.34]

2.34 **A firm shall not provide an audit or other public interest assurance 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 audit or other public interest assurance engagement of the firm.** [ES 2.35, ESRA 2.24]

2.35 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.³⁵ [ES 2.36]

Employment Relationships

2.36 **Persons or firms referred to in paragraph 2.3 shall not participate in, or otherwise be in a position to influence the conduct or outcome of, an**

³⁵ For companies, competition authorities have generally treated a 15% shareholding as sufficient to provide a material ability to influence policy.

audit or other public interest assurance engagement of any particular entity if they have had 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 2.1 that would compromise independence. [AD 22.4]

Management Role with an Entity Relevant to an Audit or Other Public Interest Assurance Engagement

2.37 A firm shall not admit to the partnership, or employ a person to undertake any auditor other public interest assurance engagement, if that person is also employed by any entity relevant to the engagement, or by any affiliate of such an entity ('dual employment'). [ES 2.37, ESRA 2.26]

Loan Staff Assignments

2.38 A firm shall not enter into an agreement with an entity relevant to an 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. [ES 2.38]**

2.39 Where a firm agrees to assist an entity relevant to an audit or other public interest assurance engagement by the firm 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. In the context of applying the requirement in paragraph 2.38(a), a short period of time is generally expected to be no more than a period of weeks or possibly a small number of months. [ES 2.39]

- 2.40 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 relevant in connection with an audit or other public interest assurance 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. [ES 2.40]
- 2.41 **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 audit or other public interest assurance engagement involving any function or activity that he or she performed or supervised during that assignment.** [ES 2.41, ESRA 2.30]
- 2.42 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 audit or other public interest assurance engagement has been completed following the completion of the loan staff assignment. [ES 2.42, ESRA 2.31]

Partners and Engagement Team Members Joining an Entity Relevant to an Audit or Other Public Interest Assurance Engagement

- 2.43 **Where a former partner in the firm joins an entity relevant to an audit or other public interest assurance 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.** [ES 2.43, ESRA 2.32]
- 2.44 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. [ES 2.44]
- 2.45 **Firms shall establish policies and procedures that require in relation to any entity relevant to an audit or other public interest assurance 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) **all partners in the firm to notify the firm of any situation involving their potential employment with any such entity; and**

- (b) other senior members of any engagement team to notify the firm of any situation involving their potential employment with any such entity; and**
- (c) other members of any engagement team to notify the firm of any situation involving their probable employment with any such entity;**
- (d) 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;**
- (d) anyone who has given such notice to be removed from the engagement team; and**
- (e) 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. [ES 2.45, ESRA 2.34]**

2.46 Integrity, objectivity and independence may be threatened where a director, an officer or an employee of any entity relevant to an audit or other public interest assurance 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 relevant in connection with an audit or other public interest assurance 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 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 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 and public disclosure of this information could compromise independence. [ES 2.46]

2.47 Where a partner in the firm or a member of an engagement team for an entity relevant to an audit or other public interest assurance engagement or another person who is personally approved as a statutory auditor as described in paragraph 2.46 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 persons in a position to influence the conduct or outcome of the engagement would not be compromised. [ES 2.47]

2.48 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. [ES 2.48]

2.49 **Where a partner, or another person who is personally approved as a statutory auditor as described in paragraph 2.46, leaves the firm and 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 entity³⁶ relevant to any audit or other public interest assurance engagement of the entity, having previously been a person in a position to influence the conduct or outcome of the engagement:**

- (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.³⁷ The firm shall not accept an audit or other public interest assurance 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 person in a position to influence the conduct or outcome of any audit or other public interest assurance engagement for the entity, has elapsed or until the person ceases employment with the entity, whichever is the sooner. [ES 2.49, ESRA 2.38]

2.50 **In the circumstances covered by paragraph 2.49, 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. [ES 2.49]**

2.51 **Where a person who is either a partner or another person who is personally approved as a statutory auditor as described in paragraph**

³⁶ [UK legislation provides that each of the Recognised Supervisory Bodies must have adequate rules and practices to ensure that a *key audit partner* (the individual responsible for the *statutory audit* and individuals responsible for a parent undertaking or a material subsidiary undertaking) of a firm appointed by a *public interest entity* as auditor is prohibited from being appointed as a director or other officer of the entity during a period of two years commencing on the date on which his or her work as *key audit partner* ended.] – to be updated in due course.

³⁷ The timing of the audit firm's resignation as auditor is determined in accordance with paragraph 1.50 of Section 1 of this Ethical Standard.

2.46 (other than someone covered by paragraph 2.49) or was a former member of an engagement team, leaves the firm and 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 in a position to influence the conduct or outcome of any engagement for the entity, the firm shall ensure that no significant connections remain between the firm and the individual and consider whether the composition of the engagement team is appropriate (paragraph 2.43 also applies in the case of a former partner). [ES 2.50, ESRA 2.39]

2.52 The firm evaluates the appropriateness of the composition of the engagement team by reference to the factors listed in paragraph 2.47 and alters or strengthens the engagement team to address any threat to the integrity, objectivity or independence of the firm or persons in a position to influence the conduct or outcome of the engagement that may be identified. [ES 2.51]

2.53 If a former partner of the firm, or another person personally approved as a statutory auditor as described in paragraph 2.46 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 audit or other public interest assurance 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 personally, within one year before acceptance of the engagement;

been a person in a position to influence the conduct or outcome of any audit or other public interest assurance 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. [new]

2.54 Where a former partner, or person personally approved as a statutory auditor as described in paragraph 2.53, left the firm earlier than the beginning of the periods specified in paragraph 2.53(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. [new]

Family Members Employed by an Entity Relevant to an Audit or Other Public Interest Assurance Engagement

2.55 Where a person in a position to influence the conduct or outcome of an audit or other public interest assurance engagement, or any partner in the firm, becomes aware that a *person closely associated* with them, or a close family member, is employed by an entity relevant to such an 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 relevant in connection with such an engagement, that person in a position to influence the conduct or outcome of the engagement 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 that would put them in a position to exert such influence on the engagement); or
- (b) in the case of a close family member of a person in a position to influence the conduct or outcome of the engagement, or any close family member of any partner in the firm, 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. [ES2.52, ESRA 2.41]

Governance Role with an Entity Relevant to an Audit or Other Public Interest Assurance Engagement

2.56 Paragraphs 2.57 to 2.59 are supplementary to certain statutory or regulatory provisions that prohibit directors of entities from being appointed as their auditor.³⁸ [ES 2.53]

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

- (a) as an officer³⁹ or member of the board of directors of an entity relevant to an audit or other public interest assurance 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 audit or other public interest assurance engagement of the firm, or in an entity in which the entity relevant to such an engagement holds directly or indirectly more than 20% of the voting rights. [ES 2.54, ESRA 2.42]

2.58 **Where a person in a position to influence the conduct or outcome of an audit or other public interest assurance engagement becomes aware that a *person closely associated* with them, or a close family member, holds a position described in paragraph 2.57, the firm shall take appropriate steps to ensure that the relevant person is excluded from any role in which they would be in a position to exert such influence on the engagement. [ES 2.55, ESRA 2.43]**

³⁸ 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.'

³⁹ As defined in Section 1173 of the Companies Act 2006 as including a director, manager or secretary.

- 2.59 **Where a partner or member of staff of the firm, not in a position to influence the conduct or outcome of an audit or other public interest assurance engagement, becomes aware that a *person closely associated* with them, or a close family member, holds a position described in paragraph 2.57, 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 consult with the Ethics Partner/Function to determine whether appropriate safeguards exist. If no such safeguards exist, the firm shall withdraw from the engagement. [ES 2.56]**

Employment with the Firm

- 2.60 Integrity and objectivity may be threatened and independence may be compromised where a former director or employee of an entity relevant to an audit or other public interest assurance engagement of the firm becomes a member of the engagement team or is otherwise in a position to influence the conduct or outcome of the engagement. 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. [ES 2.57]
- 2.61 **Where a former director or a former employee of an entity relevant to an audit or other public interest assurance engagement of the firm, who was in a position to exert significant influence over the preparation of the financial statements or other subject matter information or subject matter relevant in connection with such an engagement, joins the firm, that individual shall be excluded from any role in which they would be in a position to influence the conduct or outcome of an audit or other public interest assurance engagement relevant to that entity or its affiliates for a period of two years following the date of leaving the entity. [ES 2.58, ESRA 2.45]**
- 2.62 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 in a position to influence the conduct or outcome of the engagement may be appropriate. For example, threats to integrity, objectivity and independence may exist in relation to an audit or other public interest assurance engagement for any period where the financial statements or other subject matter information or other subject matter relevant to such 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. [ES 2.59]

Family and Other Personal Relationships

- 2.63 A relationship between a person who is in a position to influence the conduct or outcome of an audit or other public interest assurance engagement 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. [ES 2.60]
- 2.64 A distinction is made between relationships with “*persons closely associated*” (which include immediate family members – a spouse or equivalent and dependents), and close family relationships (which additionally comprise parents, non-dependent children and siblings). 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. [ES 2.61]
- 2.65 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. [ES 2.62]
- 2.66 **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, and any close family and other personal relationships, where any of those persons is involved with an entity relevant to an audit or other public interest assurance 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). [ES 2.63, ESRA 2.50]**
- 2.67 **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 2.66;**

- (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.** [ES 2.64, ESRA 2.51]

2.68 Where such matters are identified or reported, the engagement partner or the Ethics Partner 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. [ES 2.65]

External Consultants Involved in an Audit or Other Public Interest Assurance Engagement

2.69 Firms may employ external consultants as experts as part of their audit or other public interest assurance engagement, for example in order to obtain sufficient appropriate audit evidence regarding certain financial statement assertions.⁴⁰ 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. [ES 2.66]

2.70 **The engagement partner shall be satisfied that any external consultant involved in the audit or other public interest assurance engagement will act with integrity and objectivity with respect to the engagement and shall document the rationale for that conclusion.** [ES 2.67, ESRA 2.54]

2.71 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. [ES 2.68]

⁴⁰ ISA (UK and Ireland) 620 *'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 engagement partners, key partners involved in the audit or other recurring/regular public interest assurance engagement and partners and staff in senior positions, including those from other disciplines, serve as members of the engagement team for each audit or other recurring/regular public interest assurance engagement. [ES 3.5, ESRA 2.57]

3.2 Where engagement partners, key partners involved in the audit or other recurring/regular public interest assurance engagement, and partners and staff in senior positions have a long association or extensive involvement with the engagement or entity(ies) relevant to the engagement, the firm shall assess the threats to integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the engagement 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 the entity(ies) 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 either 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. [ES 3.6, ESRA 2.58]

3.3 Where engagement partners, key partners involved in the audit or other recurring/regular public interest assurance engagement, other partners and staff in senior positions have a long association or extensive involvement with the 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;
- 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 that engagement.[ES 3.7]

3.4 In order to address such threats, firms apply safeguards. Appropriate safeguards may include:

- 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. [ES 3.8, ESRA 2.62]
- 3.5 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 persons in a position to influence the conduct or outcome of the engagement 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 3.4, 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 1.59 – 1.69 of Section 1 of this Ethical Standard. [ES 3.9]
- 3.6 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 the engagement of non-listed entities that are not *public interest entities* are subject to accelerated rotation requirements, such as those set out in paragraph 3.10, as described in paragraph 1.46 of Section 1 of this Ethical Standard. [ES 3.10]
- 3.7 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. [ES 3.11]

Public Interest Entities and Other Listed Entities

Audit Firm Rotation

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

The Engagement Partner

- 3.9 **Save where the circumstances in paragraphs 3.13 and 3.14 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 five⁴¹ 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]

- 3.10 In the case of *listed entities*, save where the circumstances contemplated in paragraph 3.13 and 3.14 apply, the firm shall establish policies and procedures to ensure in respect of an audit or other recurring/regular public interest assurance 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. [ES 3.12]
- 3.11 The roles that constitute participating in an engagement for the purposes of paragraph 3.10(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 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. [ES 31.3]
- 3.12 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 audit engagement. Positions in which an individual is responsible for the firm's client relationship with the particular entity would not be an acceptable non-audit role. [ES 3.14]
- 3.13 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*. [ES 3.15]
- 3.14 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

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.

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.

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 persons in a position to influence the conduct or outcome of the engagement 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. [ES 3.16]

- 3.15 For an audit, where it has been determined that the audit 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 audit engagement partner to continue in this role. [ES 3.17]
- 3.16 In the case of joint audit arrangements for *public interest entities* and for other *listed entities*, audit firms will make arrangements for changes of audit 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. [ES 3.18]

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

- 3.17 **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]
- 3.18 **For an audit of a *public interest entity*, the ~~statutory auditor or the audit firm~~ shall be able to demonstrate to the competent authority⁴² 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]
- 3.19 In the case of *public interest entities* and other *listed entities*, the firm shall establish policies and procedures to ensure in respect of an audit or other recurring/regular public interest assurance engagement that:

⁴² Identity of the 'competent authority' to be defined in due course.

- (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,
 - 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. [ES 3.19]

Other Partners and Staff in Senior Positions

3.20 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. [ES 3.20]

3.21 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. [ES 3.21]

3.22 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 an acceptable level, the partner or member of staff is removed from the engagement team. [ES 3.22]

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 audit or other public interest assurance 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.** [ES 4.5]
- 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 audit or other public interest assurance engagement in accordance with applicable Engagement and Ethical Standards. [ES 4.6]
- 4.3 **Fees for audits or other public interest assurance engagements shall not be influenced or determined by the provision of non-audit / additional services to the entity.** [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 4.3 is intended to prevent any relationship between the appropriate cost of the engagement and the actual or potential provision of additional services. [ES 4.8]
- 4.5 Paragraph 4.3 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. [ES 4.9]
- 4.6 **Fees for the provision of ~~statutory~~ audits or other public interest assurance engagements to ~~public interest~~ entities shall not be contingent fees.** [AR 4.1] [ES 4.10, ESRA 2.65]
- 4.7 ~~Without prejudice to Article 25 of Directive 2006/43/EC, for the purposes of the first subparagraph, cContingent 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] [ES 4.11]
- 4.8 Contingent fee arrangements in respect of audit or other public interest assurance engagements create self-interest threats to the integrity and objectivity of the firm and persons in a position to influence the conduct or outcome of the engagement that are so significant that they cannot be eliminated or reduced to a level where independence would not be compromised. [ES 4.12]

- 4.9 The fee for an audit or other public interest assurance engagement does not depend on whether the firm's report on the financial statements, or on subject matter information or other subject matter that is the subject of such engagement, is qualified or unqualified. The basis for the calculation of the fee is agreed with the entity before significant engagement work is undertaken. 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. [ES 4.13]
- 4.10 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. [ESRA 2.70]
- 4.11 In relation to investment circular reporting engagements, where the firm is aware that the entity(ies) 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. [ESRA 2.71]
- 4.12 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 persons in a position to influence the conduct or outcome of the engagement, as they may have, or may appear to have, an interest in the outcome of the additional service. [ES 4.14]
- 4.13 **The firm shall not undertake an engagement to provide non-audit / additional services, in respect of an entity relevant to an audit or other public interest assurance engagement by the firm, 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 non-audit / additional service is a tax service; or**
 - (c) in the case of an entity relevant to an audit by the firm, 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 audit judgment relating to a material matter in the financial statements; or**
 - (d) in the case of an entity relevant to an other public interest assurance engagement by the firm, the amount of the fee is dependent on an outcome of those additional services that is relevant to a future or contemporary assurance judgment relating**

to a material matter that is material to the subject of such an engagement. [ES 4.15]

- 4.14 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 persons in a position to influence the conduct or outcome of the engagement could be, or be seen to be, compromised.
- 4.15 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 an engagement at the same time as an audit or other public interest assurance engagement.
- 4.16 In addition, where the contingent fee relates to tax services or 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 audit provided by the firm, or that is otherwise relevant to an other public interest assurance engagement provided by the firm, the self-interest threat cannot be eliminated or reduced to a level where independence is not compromised. [ES 4.16, ESRA 2.73]
- 4.17 Paragraph 4.13 is not intended to prohibit a firm from charging a lower fee where the engagement 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. [ES 4.17]
- 4.18 For non-audit / additional services provided on a contingent fee basis, other than those prohibited under paragraph 4.13, 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 an acceptable level. 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. [ES 4.18]
- 4.19 Examples of safeguards that might be applied to reduce to an acceptable level 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 4.13 above) include:

- the provision of such non-audit / additional services by partners and staff who have no involvement in the audit or other public interest assurance engagement;
 - review of the audit or other public interest assurance 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 engagement has been properly and effectively addressed in the context of the audit or other public interest assurance engagement. [ES 4.19]
- 4.20 **The firm shall establish policies and procedures to ensure that the engagement partner and the Ethics Partner 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 or its affiliates.** [ES 4.20, ESRA 2.72]
- 4.21 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 persons in a position to influence the conduct or outcome of the engagement. The circumstances in which such fee arrangements are not permitted for non-audit / additional services are dealt with in paragraph 4.13 of this Section. [ES 4.21]
- 4.22 **In the case of *public interest entities* and of other *listed entities* relevant to audit or other public interest assurance engagement by the firm, 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.** [ES 4.22]
- 4.23 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. [ES 4.23]
- 4.24 **For a recurring public interest assurance engagement, including an audit, 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.** [ES 4.24]
- 4.25 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. ES 4.25]
- 4.26 **Where fees for professional services from the entity are overdue and the amount cannot be regarded as trivial, the engagement partner, in consultation with the Ethics Partner, shall consider whether the firm can accept or continue an audit or other public interest assurance engagement or whether it is necessary to resign.** [ES 4.26, ESRA 2.74]
- 4.27 Where fees due from an entity, whether for audit, 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 engagement for a subsequent engagement, is due to be issued - a self-interest threat to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the engagement is created because the issue of an unqualified report may enhance the firm's prospects of securing payment of such overdue fees. [ES 4.27]

- 4.28 Where the outstanding fees are in dispute and the amount involved is significant, the threats to the integrity and objectivity of the firm and persons in a position to influence the conduct or outcome of the engagement 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. [ES 4.28]
- 4.29 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 persons in a position to influence the conduct or outcome of the engagement, if the firm were to remain appointed to provide the engagement service, 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. [ES 4.29]
- 4.30 In any case where the firm does not resign from the audit or other public interest assurance 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. [ES 4.30]
- 4.31 **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, the total fees for such services shall be limited to no more than 70 % of the average of the fees paid in the last three consecutive financial years 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]**
- 4.32 **For the purposes of the limits specified in the first subparagraph paragraph 4.31, non-audit services, other than those referred to in Article 5(1)⁶⁰ of the EU Audit Regulation, required by Union or national legislation shall be excluded. [AR 4.2]**
- 4.33 **Upon a request by the statutory auditor or the audit firm, on an exceptional basis, [the competent authority⁴⁴ may] allow that statutory auditor or audit firm to be exempt from the requirements in the first**

⁴³ See Section 5, paragraph 5.56, of this Ethical Standard.

⁴⁴ Identity of the 'competent authority' to be defined in due course.

sub-paragraph paragraph 4.31 in respect of an audited entity for a period not exceeding two financial years. [AR 4.2]

- 4.34 Paragraphs 4.35 to 4.45 below do not apply to the audits or other public interest assurance engagements of entities where the responsibility for the audit or other public interest assurance 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).
- 4.35 **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 an audit or other recurring/regular public interest assurance engagement by the firm⁴⁵ will regularly exceed 10% of the annual fee income of the firm⁴⁶ or, where profits are not shared on a firm-wide basis, of the part of the firm by reference to which the audit (or other public interest assurance engagement) engagement partner's profit share is calculated, the firm shall not act as the auditor or provider of an other recurring/regular public interest assurance engagement of that entity and shall either resign as auditor and/or provider of other recurring/regular public interest assurance engagement or not stand for reappointment, as appropriate. [ES 4.31]**
- 4.36 The requirements in paragraph 4.35 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.
- 4.37 **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 an audit or other recurring/regular public interest assurance 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 audit or other public interest assurance engagement partner's profit share is calculated, the firm shall not act as the auditor or provider of an other recurring/regular public interest assurance engagement of that entity and shall either resign as auditor and/or provider of other recurring/regular public interest assurance engagements or not stand for reappointment, as appropriate. [ES 4.32]**
- 4.38 Where it is expected that the total fees for services receivable from an entity and its subsidiaries relevant to an audit or other recurring/regular public interest assurance 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. [ES 4.33]

⁴⁵ 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.

⁴⁶ In the case of a sole practitioner, annual fee income of the firm includes all earned income received by the individual.

- 4.39 Paragraphs 4.35 and 4.37 are not intended to require the firm to resign as auditor or provider of an other public interest assurance 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 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 persons in a position to influence the conduct or outcome of the engagement and the safeguards applied to eliminate or reduce those threats to a level where independence would not be compromised. [ES 4.34]
- 4.40 **Where it is expected that the total fees services receivable from a *public interest entity* or other *listed entity* and its subsidiaries relevant to an audit or other recurring/regular public interest assurance 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 audit or other public interest assurance engagement engagement partner's profit share is calculated, but will not regularly exceed 10%, the engagement partner shall disclose that expectation to the Ethics Partner and to those charged with governance of the entity, including the audit committee where there is one, and discusses with both the threat to integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the engagement and whether safeguards need to be applied to eliminate or reduce the threat to a level where independence would not be compromised.** [ES 4.35]
- 4.41 It is fundamental to the integrity and objectivity of the firm and persons in a position to influence the conduct or outcome of the engagement 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 that is the subject of an audit or other public interest assurance engagement, since this could be viewed as likely to lead to the firm losing the engagement and the entity as a client. [ES 4.36]
- 4.42 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 an audit or other recurring/regular public interest assurance 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 consider the significance of the threat and the need for appropriate safeguards. [ES 4.37]
- 4.43 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. [ES 4.38]

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 an audit or other recurring/regular public interest assurance engagement by the firm will regularly exceed 10% of the annual fee income of the firm or the part of the firm by reference to which the audit or other public interest assurance engagement partner's profit share is calculated, but will not regularly exceed 15%, the engagement partner shall disclose that expectation to the Ethics Partner and to those charged with governance of the entity and the firm shall arrange an external independent quality control review of the audit or other recurring/regular public interest assurance engagement to be undertaken before the firm's report is finalised. [ES 4.39]**

4.45 A quality control review involves discussion with the engagement partner, a review of the financial statements or other subject matter information or subject matter that is the subject of an audit or other public interest assurance 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 audit or other public interest assurance 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 audit or other public interest assurance 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. [ES 4.40]

4.46 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 audits or other public interest assurance 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 audits or other public interest assurance engagements of non-listed entities, that are not *public interest entities*, that represent more than 15% of the annual fee income before the audit or other public interest assurance engagement opinion is issued.

The firm might also develop its practice by accepting work from entities not relevant to an audit or other public interest assurance engagement by the firm so as to bring the fees payable by each entity which is relevant to an audit or other public interest assurance engagement below 15%. [ES 4.41]

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

- is employed exclusively or principally on that audit or other recurring/regular public interest assurance engagement; and
- is remunerated on the basis of the performance of part of the firm which is substantially dependent on fees from that entity. [ES 4.42]

4.48 Where the circumstances described in paragraph 4.47 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 person in a position to influence the conduct or outcome of the audit or other recurring/regular public interest assurance engagement by reallocating the work within the practice;
- a review by an engagement partner with relevant expertise who is not involved with the audit or other public interest assurance engagement to ensure that the integrity, objectivity or independence of the firm and persons in a position to influence the conduct or outcome of the engagement is not affected by the self-interest threat. [ES 4.43]

Remuneration and Evaluation Policies

4.49 **A firm shall have in place adequate remuneration policies, including profit-sharing policies, providing sufficient performance incentives to secure audit and other public interest assurance 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 person involved in, or able to influence the carrying out of, the audit or other public interest assurance engagement. [AD 24a.1(j)]**

4.50 **The firm shall establish policies and procedures to ensure that each of the following is true in relation to each entity relevant to an audit or other public interest assurance 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 audit or other public interest assurance engagement is clearly insignificant. [ES 4.44]

- 4.51 Where the firm, its partners or staff identify areas for possible improvement in an entity relevant to an audit or other public interest assurance 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 audit or other public interest assurance 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 persons in a position to influence the conduct or outcome of the engagement are compromised. [ES 4.45]
- 4.52 The last sentence of paragraph 4.50 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 audit or other public interest assurance engagement is clearly insignificant. [ES 4.46]
- 4.53 The policies and procedures required for compliance with paragraph 4.50 are not intended to inhibit normal profit-sharing arrangements. However, such policies and procedures are central to the ability of a firm that provides audit or other public interest assurance engagement services to demonstrate the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the engagement, and to rebut any suggestion that an audit or other public interest assurance engagement that it has undertaken and the 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 pays particular attention to the actual implementation of those policies and procedures and is available for consultation when needed. [ES 4.47]

Gifts and Hospitality

- 4.54 **A firm, its partners and any person in a position to influence the conduct or outcome of an audit or other public interest assurance engagement, 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] [ES 4.51, 4.52, ESRA 2.82, 2.83]**

- 4.55 Where gifts, favours or hospitality are accepted from an entity relevant to an audit or other public interest assurance engagement by the firm, 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 person in a position to influence the conduct or outcome of the engagement are created. Familiarity threats also arise where gifts, favours or hospitality are offered to an entity relevant to an audit or other public interest assurance engagement by the firm, its partners or any other person in a position to influence the conduct or outcome of the engagement. [ES 4.53]
- 4.56 **The firm shall establish policies on the nature and value of gifts, favours and hospitality that may be accepted from and offered to entities relevant to an audit or other public interest assurance engagement by the firm, 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.** [ES 4.56, ESRA 2.87]
- 4.57 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.
- 4.58 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, for further consideration regarding any action to be taken. [4.58]

Threatened and Actual Litigation

- 4.59 Paragraphs 4.60 and 4.61 below, which support supporting ethical provision 2.11, do not apply to the audits or other public interest assurance 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.
- 4.60 Where litigation (in relation to any services) actually takes place between the firm or its partners (or any person in a position to influence the conduct or outcome of the engagement) and the entity or its affiliates, or where litigation is threatened and there is a realistic prospect of such litigation being commenced, self-interest, advocacy and intimidation threats to the integrity, objectivity and independence of the firm, its partners and any person in a position to influence the conduct or outcome of the engagement 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 audit or other public interest assurance 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, 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. [ES 4.49, ESRA 2.80]

4.61 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 audit or other public interest assurance engagement was about to be completed, and shareholder 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. [4.50]

Section 5 – Non-audit / Additional Services

General Approach to Non-audit / Additional Services

- 5.1 Paragraphs 5.2 to 5.51 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 5.64 to 5.181 of this Section illustrate the application of the general approach to a number of common non-audit / additional services.) [ES 5.5]
- 5.2 ISAs (UK and Ireland) require that the auditor 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 obtained¹. [ES 5.7]
- 5.3 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:
- Identifying, evaluating and testing, where appropriate, those internal control systems the effectiveness of which is necessary for the audit or other public interest assurance 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 the financial statements or on other subject matter information or subject matter in the case of an other public interest assurance engagement. [ES 5.8]
- 5.4 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 audit or other public interest assurance 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 in the case of an other public interest assurance engagement, to be expressed. Therefore, an audit or other public interest assurance engagement does not include work where:

¹ ISA (UK and Ireland) 200 'Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK and Ireland)' paragraph 7.

- 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; 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; or
- The principal terms and conditions differ from that of the audit or other public interest assurance engagement. [ES 5.9]

5.5 In the context of an audit, if additional work on financial information² 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' 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. [ES 5.10]

5.6 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;

will be regarded as an 'other non-audit service' for the purpose of this Ethical Standard. [ES 5.11]

5.7 'Non-audit services' 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 in respect of the audited entity³;

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

'Additional services' comprise any engagement in which a firm, or a member of its network, provides professional services to:

- an entity for which the firm undertakes a public interest assurance engagement other than audit;

² This does not include accounting services.

³ For example, where an engagement is undertaken to assist in the preparation of listing particulars for a company acquiring the audited entity

- affiliates of an entity for which the firm undertakes a public interest assurance engagement other than audit;
 - another entity in respect of the entity for which the firm undertakes a public interest assurance engagement other than audit. [ES 5.12]
- 5.8 There may be circumstances where the firm is engaged to provide a non-audit / additional service and where that engagement 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 audit or other public interest assurance engagement by the firm, may gain some benefit from that non-audit / additional service engagement⁴. In these circumstances, whilst there may be no threat to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement at the time of appointment, the firm considers how the non-audit / additional service engagement may be expected to develop, whether there are any threats that the firm may be subject to if additional relevant parties which are entities relevant to an audit or other public interest assurance engagement by the firm, are identified, and whether any safeguards need to be put in place. [ES 5.13]
- 5.9 **The firm shall establish policies and procedures that require others within the firm, when considering whether to accept a proposed engagement to provide a non-audit / additional service to an entity relevant to an audit or other public interest assurance engagement, other than an investment circular reporting engagement, by the firm, or any of its affiliates, to communicate details of the proposed engagement to the engagement partner.** [ES 5.14]
- 5.10 The firm establishes appropriate channels of internal communication to ensure that, in relation to an entity relevant to an audit or other public interest assurance engagement by the firm, the engagement partner (or their delegate) is informed about any proposed engagement to provide a 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement before the non-audit / additional service engagement is accepted. Additionally, when addressing services provided to another entity in respect of the entity relevant to an audit or other public interest assurance engagement by the firm, the procedures address any requirement to preserve client confidentiality. [ES 5.15]
- 5.11 In the case of a group audit of a *public interest entity* or an other *listed entity* the group audit engagement partner establishes that the company 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

⁴ 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.

the affiliates will comply with this policy.⁵ The group audit engagement partner also requires that relevant information on non-audit services provided by network firms is communicated on a timely basis. [ES 5.16]

Investment Circular Reporting Engagements

5.12 In relation to an investment circular reporting engagement, this Section applies only to those additional services provided by the firm to the entity(ies) relevant to the engagement during the relevant period. The relevant period covers the period during which the 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 the entity(ies) 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 the entity(ies) 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. [ESRA 3.4]

5.13 **In relation to investment circular reporting engagements, the firm should establish policies and procedures, including the alternative procedures outlined in paragraph 1.39 of Section 1 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 accepted an engagement to provide during the relevant period, an other service to an entity relevant to the engagement or any of that entity's significant affiliates.** [ESRA 3.5]

5.14 The firm establishes appropriate policies and procedures to ensure that, in relation to an entity relevant to an investment circular reporting engagement, any engagement to provide an other 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 persons in a position to influence the conduct or outcome of the investment circular reporting engagement before the investment circular reporting engagement is accepted. Such policies and procedures are likely to involve:

- (i) enquiries of the entity(ies) relevant to the engagement;
- (ii) reference to records of past and current other service engagements provided by the firm;
- (iii) enquiries of network firms involved in the investment circular reporting engagement as to whether they have provided any other service engagement 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. [ESRA 3.6]

⁵ 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.

Identification and Assessment of Threats and Safeguards

5.15 **Before the firm accepts a proposed engagement to provide a non-audit / additional service to an entity relevant to an audit or other public interest assurance engagement by the firm, the engagement partner for the audit or other public interest assurance engagement shall:**

- (a) identify and assess the significance of any related threats to the integrity or objectivity of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement, 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 engagement would not impair integrity or objectivity and compromise the independence of the firm or persons in a position to influence the audit or other public interest assurance engagement. ES 5.17]**

5.16 When assessing the significance of threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the engagement, 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 in the case of an other public interest assurance engagement;
- The extent to which performance of the proposed non-audit / additional service engagement will involve the exercise of professional judgment;
- The size of the non-audit / additional service engagement 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 service⁶;
- The staff from the entity relevant to the audit or other public interest assurance engagement who would be involved in the non-audit / additional service⁷.

To ensure that this assessment is made with a proper understanding of the nature of the engagement, it may be necessary to refer to a draft engagement

⁶ For example, where those handling the non-audit service engagement 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.

⁷ 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.

letter in respect of the proposed non-audit / additional services or to discuss the engagement with the partner involved. [ES 5.18]

- 5.17 The assessment of the threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement arising from any particular non-audit / additional engagement is a matter for the engagement partner responsible for the audit or other public interest assurance engagement. The engagement partner may decide to delegate some information gathering activities to senior personnel on the audit or other public interest assurance 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 the FRC's 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. [ES 5.19]
- 5.18 Where the engagement partner is not able to undertake the assessment of the significance of threats in relation to a proposed engagement to provide a non-audit / additional service to an entity relevant to an audit or other public interest assurance engagement by the firm, for example due to illness or holidays, alternative arrangements are established (for example, by authorising the engagement quality control reviewer to consider the proposed engagement). [ES 5.20]
- 5.19 **Where it is probable that an objective, reasonable and informed third party would conclude that the proposed non-audit / additional service engagement would impair integrity or objectivity and compromise the independence of the firm or persons in a position to influence the audit or other public interest assurance engagement, the firm shall either:**
- (a) not undertake the non-audit / additional service engagement; or**
 - (b) not accept or withdraw from the audit or other public interest assurance engagement. [ES 5.22, ESRA 3.7]**
- 5.20 The objectives of engagements to provide non-audit / additional services vary and depend on the specific terms of the engagement. In some cases these objectives may be inconsistent with those of the audit or other public interest assurance engagement, and, in such cases, this may give rise to a threat to the integrity or objectivity of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement and to the appearance of their independence. [ES 5.23]
- 5.21 Similarly, in relation to a possible appointment as auditor or provider of an 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 engagements to provide non-audit / additional services by the firm. The firm does not accept appointment to undertake an audit or other public interest assurance engagement unless it is probable that an objective, reasonable and informed third party, taking into account safeguards applied, would not conclude that the independence of the firm or persons in a position to influence the audit or other public interest assurance engagement are not compromised.

- 5.22 When tendering for a new investment circular reporting engagement or, in the case of *public interest entities* and other *listed entities*, when tendering for a new audit 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 audit or other public interest assurance engagement;
 - whether those non-audit / additional services would have been prohibited if the entity had been an entity relevant to an audit or other public interest assurance 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. [ES 5.24, ESRA 3.10]

Threats to objectivity and independence

- 5.23 As identified in Section 1, the principal types of threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement 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. [ES 5.25]

- 5.24 A **self-interest threat** exists when the firm, its partners and any person in a position to influence the conduct or outcome of the engagement have financial or other interests which might cause them to be reluctant to take actions that would be adverse to the interests of the firm or any individual in a position to influence the conduct or outcome of the audit or other public interest assurance engagement. In relation to non-audit / additional services, the main self-interest threat concerns fees and economic dependence and these are addressed in Section 4 of this Ethical Standard. [ES 5.26]
- 5.25 For *public interest entities* audited by the firm there is a cap on fees for non-audit services that are not required by law (see paragraph 4.31 of Section 4 of this Ethical Standard). 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 the audit or other recurring public interest assurance engagement, 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 engagement team. In making that assessment, the engagement partner considers matters such as whether the engagement or engagements giving rise to the fees for non-audit / additional services were:

- audit related services;
- provided on a contingent fee basis;
- consistent with the engagements 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 engagements would have on the integrity, objectivity and independence of the engagement team.

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 those charged with governance of the position on a timely basis in accordance with paragraphs 5.46 to 5.48 of this this Section. [ES 5.27]

5.26 **In the case of *public interest entities* and of other *listed entities* where the fees for non-audit / additional services for a financial year are expected to be greater than the annual audit fees or fees for an other recurring/regular public interest assurance engagement, the engagement partner for the audit or other public interest assurance engagement shall provide details of the circumstances to the Ethics Partner and discuss them with him or her. Where the firm provides audit or other public interest assurance engagement services to a group, the obligation to provide information to the Ethics Partner shall be on a group basis for all services provided by the firm and its network firms to all entities in the group. [ES 5.28]**

5.27 Discussing the level of fees for non-audit / additional services with the Ethics Partner 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 audit or other public interest assurance engagement discusses the level of non-audit / additional service fees with the Ethics Partner for non-listed entities, that are not *public interest entities*, as described in paragraph 1.46 of Section 1 of this Ethical Standard. [ES 5.29]

- 5.28 Where fees for non-audit / additional services are calculated on a contingent fee basis, there is a risk that an objective, reasonable and informed third party may regard the firm's interests to be so closely aligned with the entity relevant to an audit or other public interest assurance engagement by the firm that it threatens the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement. Consequently, as required by paragraph 4.13 of Section 4 of this Ethical Standard, the firm does not provide a non-audit / additional services 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 non-audit / additional service is a tax service; or
 - (c) in the case of an entity relevant to an audit by the firm, 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 audit judgment relating to a material matter in the financial statements; or
 - (d) in the case of an entity relevant to an other public interest assurance engagement by the firm, the amount of the fee is dependent on an outcome of those additional services that is relevant to a future or contemporary assurance judgment relating to a material matter that is material to the subject of such an engagement. [ES 5.30]
- 5.29 A **self-review threat** exists when the results of a non-audit / additional service performed by the engagement team or by others within the firm are reflected in the amounts included or disclosed in the audited financial statements or in other subject matter information or subject matter in the case of an other public interest assurance engagement). [ES 5.31]
- 5.30 A threat to integrity, objectivity and independence arises because, in the course of the audit or other public interest assurance engagement, the engagement team 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 information or subject matter in the case of an other public interest assurance engagement, it may be or may appear to be unable to take an impartial view of relevant aspects of those financial statements. [ES 5.32]
- 5.31 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 in the case of an other public interest assurance engagement). [ES 5.33]
- 5.32 Where a significant degree of judgment relating to the financial statements, or other subject matter information or subject matter that is the subject of an other public interest assurance engagement, is involved in a non-audit /

additional service engagement, the persons conducting the audit or other public interest assurance 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 persons in a position to influence the conduct or outcome of the engagement and the appearance of their independence may be adversely affected. 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 subject matter in the case of an other public interest assurance engagement, it is unlikely that any safeguard can eliminate or reduce the self-review threat to a level where independence is not compromised. [ES 5.34]

- 5.33 A **management threat** exists when the firm undertakes work that involves making judgments and taking decisions that are properly the responsibility of management. [ES 5.35]
- 5.34 Ethical provision 2.1 of this Ethical Standard prohibits the firm and any person in a position to influence the conduct or outcome of the audit or other public interest assurance engagement from being involved in the decision taking of the entity. A threat to integrity, objectivity and independence also arises where the firm undertakes an engagement to provide non-audit / additional services in relation to which management are required to make judgments and take decisions based on that work. The persons conducting the engagement 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 the engagement to apply a proper degree of professional scepticism. The integrity and objectivity of the firm and any person in a position to influence the conduct or outcome of the engagement and the appearance of their independence therefore may be, or may be perceived to be compromised. [ES 5.36]
- 5.35 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:
- the persons conducting the engagement are satisfied that 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 paragraph 1.26 of Section 1 of this Ethical Standard that are needed;
 - the persons conducting the engagement conclude that 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 they are

supported by an objective analysis of the issues to consider and the entity is given the opportunity to decide between reasonable alternatives. [ES 5.37]

- 5.36 In the absence of such informed management it is unlikely that any other safeguards can eliminate a management threat or reduce it to an acceptable level. [ES 5.38]
- 5.37 An **advocacy threat** exists when the firm undertakes work that involves acting as an advocate for an entity relevant to an audit or other public interest assurance engagement by the firm and supporting a position taken by management in an adversarial context. [ES 5.39]
- 5.38 A threat to integrity, objectivity and independence arises because, 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 persons in a position to influence the conduct or outcome of the engagement. 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 the audit of the financial statements. [ES5.40]
- 5.39 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 to subject matter information or subject matter in the case of an other public interest assurance engagement, it is unlikely that any safeguards can eliminate or reduce the advocacy threat to a level where independence would not be compromised. [ES 5.41]
- 5.40 Threats to the integrity or objectivity of the firm and persons in a position to influence the conduct or outcome of the engagement, including threats that could compromise independence, may 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 audit or other public interest assurance engagement by the firm, and the outcome of that service has a material impact on the financial statements of the entity or to subject matter information or subject matter that is the subject of an other public interest assurance engagement. 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. [ES 5.42]

Safeguards

- 5.41 Where any threat to the integrity and objectivity of the firm or any person in a position to influence the conduct or outcome of the engagement 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 engagement to

provide the non-audit / additional service in question or not to accept or to withdraw from the audit or other public interest assurance engagement. [ES 5.43]

5.42 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 audit or other public interest assurance 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 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. Where notified of a breach, the Ethics Partner 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 for the audit or other public interest assurance engagement and the partner leading the non-audit / additional services engagement, reviews the work and conclusions of the engagement team for the audit or other public interest assurance engagement. 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 audit or other public interest assurance opinion 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 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. [ES 5.44]

- 5.43 **Where the engagement partner concludes, with respect to threats to the integrity or objectivity of the firm or persons in a position to influence the conduct or outcome of the engagement, including any threats that could compromise independence, related to a proposed engagement to provide a 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 engagement; or**
 - (b) not accept or withdraw from the audit or other public interest assurance engagement.**

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. [ES 5.45]

- 5.44 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 an engagement to provide 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 engagement, or does not accept or withdraws from the audit or other public interest assurance engagement as appropriate. [ES 5.46]
- 5.45 Where there is doubt as to the appropriate action to be taken, consultation with the Ethics Partner ensures that an objective judgment is made and the firm's position is consistent. [ES 5.47]

Communication with Those Charged With Governance

- 5.46 **The engagement partner for the audit or other public interest assurance engagement shall ensure that those charged with governance of the entity are appropriately informed on a timely basis of:**
- (a) all significant facts and matters that bear upon the integrity, objectivity or independence of the firm and persons in a position to influence the conduct or outcome of the engagement, related to the provision of non-audit / additional services, including the safeguards put in place; and**
 - (b) for *public interest entities* and for other *listed entities*, any inconsistencies between the FRC's Ethical Standard and the company's policy for the supply of non-audit / additional services by the firm and any apparent breach of that policy.⁶ [ES 5.48]**

- 5.47 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. This can be facilitated by timely communication with those charged with governance of the entity (see Section 1 of this Ethical Standard, paragraphs 1.59 to 1.69). Such communications are addressed to the audit committee, where there is one; in other circumstances, they are addressed to the board of directors (or those in an equivalent position). In the case of *public interest entities* and other *listed entities*, 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 engagement of the external auditor to supply non-audit services. This will include discussion of any inconsistencies between the company's policy and the FRC's Ethical Standard and ensuring that the policy is communicated to affiliates. [ES 5.49]
- 5.48 Communications with those charged with governance regarding the impact on the integrity, objectivity or independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement of non-audit / additional services are likely to be facilitated if disclosure of such non-audit / additional services distinguishes between audit related services and other non-audit / additional services (as defined in this Standard). [ES 5.50]

Documentation

- 5.49 **The engagement partner for the audit or other public interest assurance engagement shall ensure that the reasoning for a decision to undertake an engagement to provide non-audit / additional services, and any safeguards adopted, is appropriately documented.** [ES 5.51]
- 5.50 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. [ES 5.52]
- 5.51 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. [ES 5.53]

Audit Related Services

- 5.52 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 law, are still subject to the 70% cap (see paragraph 4.31 of Section 4 of this Ethical Standard) and still require approval by the audit committee. [ES 5.54]

5.53 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 information⁸ and/or financial controls where this work is integrated with the audit work and is performed on the same principal terms and conditions. [ES 5.55]

5.54 **The audit engagement partner shall ensure that only those non-audit services listed in paragraph 5.53 are described as audit related services in communications with those charged with governance of the audited entity. [ES 5.56]**

5.55 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 5.53 above⁹.

Prohibited Non-audit Services for *Public Interest Entities*

5.56 ~~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:

⁸ This does not include accounting services.

⁹ This legislation is under review – paragraphs 5.52-5.55 will be amended if necessary when the Ethical Standard is finalised.

- (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]

5.57 By way of derogation from the second subparagraph of paragraph 4 5.56, 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 have ~~immaterial~~ a clearly 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 of the EU Audit Regulation~~]; 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.

5.58 ~~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 paragraphs 1 and 2 5.56 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 5.59. [AR 5.4]

5.59 ~~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 paragraphs 1 and 2 5.56 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]~~

5.60 ~~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 22b¹⁰ of the EU Audit Directive 2006/43/EC, that such provision of services does not affect his, her or its professional judgement and the audit report. [AR 5.5]~~

5.61 ~~For the purposes of this paragraph the requirement in paragraph 5.60:~~

~~(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 4 5.56 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 4-5.56 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]~~

5.62 Supporting ethical provision 2.4 of this Ethical Standard, requires that for a group audit, all network firms (whether or not involved in the group audit), and third party firms whose work is used in the conduct of the group audit, shall be behave with integrity and objectivity, and shall be independent with respect to the group audit engagement, in accordance with: in the case of a network firm whose work is used in the conduct of the group audit, the overarching principles, supporting ethical provisions and specific requirements established in this Ethical Standard as applicable to the group auditor; and, in the case of any other network or third party firm, the extant version of the IESBA Code.

5.63 The audit firm's policies and procedures will set out whether there are circumstances in which the services specified in paragraph 5.56 are not undertaken for entities that are not *public interest entities* as described in paragraph 1.46 of Section 1 of this Ethical Standard.

Evaluation of Specific Non-audit Services and Additional Services

5.64 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 audit or other public interest assurance engagement by the firm. 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 5.56 above, that more stringent requirement shall also apply.

¹⁰ See Section 1, paragraph 1.72, of this Ethical Standard.

- 5.65 For example, with regards to valuation services, paragraph 5.88 requires that the firm shall not provide such services to a *listed entity* with a market capitalisation of more than £100m, 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 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 5.56 prohibits the provision of valuation services, subject to the derogation in paragraph 5.57, including that the service has no direct or has a clearly inconsequential effect, separately or in the aggregate on the audited financial statements of the *public interest entity*.
- 5.66 **For the purpose of the requirements below, the market capitalisation of a *listed entity* shall, where applicable, be determined as the average of the entity's market capitalisation on the first and last day of the year ended six months prior to the start of the most recent accounting period for which an auditor's report on the entity's financial statements has not yet been signed. Once an entity is determined to have a market capitalisation of more than £100m for the purpose of this Ethical Standard it shall continue to be treated as such an entity for all future audit or other public interest assurance engagements by all firms undertaking such engagements after this Ethical Standard comes into effect, unless its market capitalisation falls below £100m and stays below that level for the remainder of that financial year and the next two financial years. [New]**
- 5.67 There are services other than audit related services 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. [ES 5.57]

The above list is not intended to be fully comprehensive and does not preclude other services being provided.

Internal Audit Services

5.68 The range of 'internal audit services' is wide and they may not be termed as such by an entity relevant to an audit or other public interest assurance engagement by the firm. For example, the firm may be engaged:

- 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 engagements would fall within the term 'internal audit services'. [ES 5.58]

5.69 The nature of possible internal audit services is also wide. While the internal audit remit will vary from company to company, 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. [ES 5.59]

5.70 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement 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. [ES 5.60]

5.71 Engagements to provide internal audit services - other than those prohibited in paragraph 5.73 - may be undertaken, provided that the firm is satisfied that

there is informed management and appropriate safeguards are applied to reduce the self-review threat to a level where independence is not compromised. [ES 5.61]

5.72 Examples of safeguards that may be appropriate when internal audit services are provided to an entity relevant to an audit or other public interest assurance engagement by the firm include ensuring that:

- internal audit projects undertaken by the firm are performed by partners and staff who have no involvement in the external audit of the financial statements or other public interest assurance engagement;
- the engagement is reviewed by partner with relevant expertise who is not involved in the audit or other public interest assurance engagement, to ensure that the internal audit work performed by the firm has been properly and effectively assessed in the context of the audit of the financial statements or other public interest assurance engagement. [ES 5.62]

5.73 **The firm shall not undertake an engagement to provide internal audit services to an entity relevant to an audit or other public interest assurance engagement by the firm where it is reasonably foreseeable that:**

- (a) for the purposes of the audit of the financial statements or other public interest assurance engagement, the firm would place significant reliance on the internal audit work performed by the firm; or**
- (b) for the purposes of the internal audit services, the firm would undertake part of the role of management. [ES 5.63, ESRA 3.17]**

5.74 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 audit of the financial statements or other public interest assurance engagement without placing significant reliance on the work performed for the purposes of the internal audit services engagement. In the case of *listed entities* with a market capitalisation of more than £100m, the provision of internal audit services in relation to the following examples is likely to be unacceptable as the external audit team is likely to place significant reliance on the work performed by the internal audit team in relation to the audited 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 audited entity. [ES 5.64]

5.75 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 audited 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. [ES 5.65]

5.76 During the course of the audit or public interest assurance engagement, the persons conducting the engagement may evaluate the design and tests 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 audit or other public interest assurance engagement rather than the result of a specific engagement to provide non-audit services and therefore does not constitute internal audit services for the purposes of this Ethical Standard. [ES 5.66]

5.77 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 information or subject matter in the case of an other public interest assurance engagement, such work is considered to be audit or public interest assurance work for the purposes of this Ethical Standard (see paragraphs 5.5 and 5.6). [ES 5.67]

5.78 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' 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. [ES 5.68]

5.79 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 audit 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. [ES 5.69]

- 5.80 In some circumstances, extended work on information and/or controls over such information that is the subject of a public interest assurance engagement may be requested. 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 persons in a position to influence the conduct or outcome of the assurance engagement. 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.

Information Technology Services

- 5.81 Design, provision and implementation of information technology (including financial information technology) systems by firms for entities relevant to an audit or other public interest assurance engagement by them creates threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the engagement. The principal threats are the self-review threat and the management threat. [ES 5.70]

- 5.82 Engagements to design, provide or implement information technology systems that are not important to any significant part of the accounting system or to the production of the financial statements and do not have significant reliance placed on them by the persons conducting the audit or other public interest assurance engagement, may be undertaken, 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. [ES 5.71]

- 5.83 Examples of safeguards that may be appropriate when information technology services are provided to an entity relevant to an audit or other public interest assurance engagement by the firm include ensuring that:

- information technology projects undertaken by the firm are performed by partners and staff who have no involvement in the external audit of the financial statements or in other public interest assurance work;
- the work undertaken in the course of the audit or other public interest assurance 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. [ES 5.72]

- 5.84 **The firm shall not undertake an engagement to design, provide or implement information technology systems for an entity relevant to an audit or other public interest assurance engagement by the firm where:**

- (a) the systems concerned would be important to any significant part of the accounting system or to the production of the financial statements, or of other subject matter information or subject matter 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 audit or other public interest assurance engagement; or**

(b) for the purposes of the information technology services, the firm would undertake part of the role of management. [ES 5.73, ESRA 3.25]

- 5.85 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 an acceptable level. 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 (or other reporting that is the subject of an other public interest assurance engagement). [ES 5.74]
- 5.86 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement that cannot be addressed through applying appropriate safeguards. [ES 5.75]

Valuation Services

- 5.87 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. [ES 5.76]
- 5.88 **The firm shall not undertake an engagement to provide a valuation to:**
- (a) an entity that is a *listed entity* with a market capitalisation of more than £100m (see paragraph 5.66), 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 other subject matter information or subject matter in the case of an other public interest assurance engagement, either separately or in aggregate with other valuations provided; or**
 - (b) any other entity, where the valuation would both involve a significant degree of subjective judgment and have a material effect on the financial statements being audited, or other subject matter information or subject matter in the case of an other public interest assurance engagement either separately or in aggregate with other valuations provided.** [ES 5.77, ESRA 3.28]
- 5.89 The main threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement 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 in the case of an other public interest assurance engagement. [ES5.78]

5.90 For *listed entities* with a market capitalisation of more than £100m, 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 in the case of an other public interest assurance engagement. [ES 5.79]

5.91 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 1.46 of Section 1 of this Ethical Standard. [ES 5.80]

5.92 In circumstances where the firm is designated by legislation or regulation as being required to carry out a valuation the restrictions in paragraph 5.88 do not apply. In such circumstances, the engagement partner applies relevant safeguards to reduce threats to integrity, objectivity and independence to a level where independence is not compromised. [ES 5.81]

5.93 It is usual for the persons conducting an audit (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 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. [ES 5.82]

5.94 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. [ES 5.83]

Actuarial Valuation Services

5.95 **The firm shall not undertake an engagement to provide actuarial valuation services to:**

- (a) an entity that is a *listed entity* with a market capitalisation of more than £100m (see paragraph 5.66), 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 being audited, or other subject matter information or subject matter in the case of an other public interest assurance engagement, either separately or in aggregate with other valuations provided; or**

(b) any other audited entity, 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 being audited, or other subject matter information or subject matter in the case of an other public interest assurance engagement, either separately or in aggregate with other valuations provided. [ES 5.84, ESRA 3.32]

5.96 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 audit, or other subject matter information or subject matter 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 audit or other public interest assurance engagement by them. [ES 5.85]

5.97 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement. [ES 5.86]

5.98 For *listed entities* with a market capitalisation of more than £100m, 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 in the case of an other public interest assurance engagement. [ES 5.87]

5.99 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 1.46 of Section 1 of this Ethical Standard. [ES 5.88]

Tax Services

5.100 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 in the case of an other public interest assurance engagement.

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 engagements 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement before deciding whether to undertake a proposed engagement to provide tax services to an entity relevant to an audit or other public interest assurance engagement by the firm. [ES 5.89]

- 5.101 The provision of tax services by firms to entities relevant to an audit or other public interest assurance engagement by them may give rise to a number of threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement, 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 in the case of an other public interest assurance engagement, the self-review threat. [ES 5.90]
- 5.102 Where the firm provides advice to the entity 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 undertake such engagements, 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. [ES 5.91]
- 5.103 Examples of such safeguards that may be appropriate when tax services are provided to an entity relevant to an audit or other public interest assurance engagement by the firm include ensuring that:
- the tax services are provided by partners and staff who have no involvement in the audit of the financial statements or other public interest assurance 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 audit of the financial statements or other public interest assurance engagement. [ES 5.92]
- 5.104 **The firm shall not promote tax structures or products or undertake an engagement to provide tax advice to an entity relevant to an audit or other public interest assurance engagement by the firm 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, in the case of an audit, the requirement for the financial statements to give a true and fair view. [ES 5.93, ESRA 3.39]

- 5.105 Where the firm promotes tax structures or products or undertakes an engagement to provide tax advice to the entity, 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 audit or other public interest assurance 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 entities relevant to an audit or other public interest assurance engagement by them 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. [ES 5.94]
- 5.106 **The firm shall not undertake an engagement to provide tax services to an entity relevant to an audit or other public interest assurance engagement by the firm where the engagement would involve the firm undertaking a management role.** [ES 5.97, ESRA 3.43]
- 5.107 When providing tax services to an entity relevant to an audit or other public interest assurance engagement by the firm, there is a risk that the firm undertakes a management role, unless the firm is working with informed management. [ES 5.98]
- 5.108 **Where an entity is a *listed entity* with a market capitalisation of more than £100m (see paragraph 5.66), or a significant affiliate of such an entity, the firm shall not undertake an engagement to prepare current or deferred tax calculations that are or may reasonably be expected to be used when preparing accounting entries that are material to the financial statements of the entity.** [ES 5.99]
- 5.109 For *listed entities* with a market capitalisation of more than £100m, 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 undertake an engagement to prepare calculations of current or deferred tax liabilities or assets for the purpose of preparing accounting entries that are material to the relevant financial statements being audited, or to other subject matter information or subject matter in the case of an other public interest assurance engagement, together with associated disclosure notes. [ES 5.100]
- 5.110 Paragraph 5.108 is not intended to prevent a firm preparing tax calculations after the completion of the engagement for the purpose of submitting tax returns. [ES 5.101]
- 5.111 For entities other than *public interest entities* and other *listed entities* with a market capitalisation of more than £100m, or significant affiliates of *listed entities* with a market capitalisation of more than £100m, the firm may

undertake an engagement 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. [ES 5.102]
- 5.112 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 1.46 of Section 1 of this Ethical Standard. [ES5.103]
- 5.113 **The firm shall not undertake an engagement to provide tax services to an entity relevant to an audit or other public interest assurance engagement by the firm 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 in the case of an other public interest assurance 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 being audited, or other subject matter information or subject matter in the case of an other public interest assurance engagement. [ES 5.104, ESRA 3.45]**
- 5.114 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement may arise. [ES 5.105]
- 5.115 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. [ES 5.106]
- 5.116 Where the 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 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 in the case of an other public interest assurance engagement, or is dependent on a future or contemporary judgment by the firm in relation to the audit or other public interest assurance engagement, the firm discusses the matter with the entity and makes it clear that it will have to withdraw from that element of the engagement to provide tax services that requires it to act as advocate for the entity, or resign from the audit or other public interest

assurance engagement from the time when the matter is formally listed for hearing before the appeals tribunal. [ES 5.107]

- 5.117 The firm is not, however, precluded from having a continuing role (for example, responding to specific requests for information) for the entity in relation to the appeal. The firm assesses the threat associated with any continuing role in accordance with paragraphs 5.118 to 5.120 of this Section. [ES 5.108]

Litigation Support Services

- 5.118 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. [ES 5.109]

- 5.119 **The firm shall not undertake an engagement to provide litigation support services to:**

- (a) **an entity that is a *listed entity* with a market capitalisation of more than £100m (see paragraph 5.66), 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 being audited by the firm, or in other subject matter information or subject matter in the case of an other public interest assurance engagement, either separately or in aggregate with other estimates and valuations provided; or**
- (b) **any other 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 financial statements being audited by the firm, or in other subject matter information or subject matter in the case of an other public interest assurance engagement, either separately or in aggregate with other estimates and valuations provided and there is a significant degree of subjectivity involved. [ES 5.110, ESRA 3.50]**

- 5.120 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. [ES 5.111]

- 5.121 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 1.46 of Section 1 of this Ethical Standard. [ES 5.112]

Legal Services

- 5.122 **The firm shall not undertake an engagement to provide legal services to an entity relevant to an audit or other public interest assurance**

engagement by the firm, 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 in the case of an other public interest assurance engagement. [ES 5.113, ESRA 3.53]

- 5.123 Although the provision by the firm of certain types of legal services to entities relevant to an audit or other public interest assurance engagement by the firm 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 audit or other public interest assurance engagement, this Ethical Standard prohibits a firm from acting as the formally nominated representative for entity relevant to an audit or other public interest assurance engagement by the firm in the resolution of a dispute or litigation which is material to the financial statements (either in terms of the amounts recognised or disclosed in the financial statements, or in other subject matter information or subject matter in the case of an other public interest assurance engagement). [ES 5.114]

Recruitment and Remuneration Services

- 5.124 **The firm shall not undertake an engagement to provide recruitment services to an entity relevant to an audit or other public interest assurance engagement by the firm, that would involve the firm taking responsibility for the appointment of any director or employee of the entity. [ES 5.115, ESRA 3.55]**
- 5.125 A management threat arises where firm personnel take responsibility for any decision as to who is appointed by the entity. [ES 5.116]
- 5.126 **For an entity relevant to an audit or other public interest assurance engagement by the firm that is a *listed entity* with a market capitalisation of more than £100 million (see paragraph 5.66), the firm shall not undertake an engagement to provide recruitment services in relation to a key management position of the entity, or a significant affiliate of such an entity. [ES 5.117]**
- 5.127 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 *listed entities* with a market capitalisation of more than £100m, and for significant affiliates of such entities, the firm does not undertake engagements that involve the recruitment of individuals for key management positions. [ES 5.118]
- 5.128 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 1.46 of Section 1 of this Ethical Standard. [ES 5.119]

5.129 Where the firm 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 being appointed to provide audit or other public interest assurance services, 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement, 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 information or transaction that is the subject of the audit or other public interest assurance engagement;
- 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. [ESRA 3.57]

5.130 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 prohibition set out in paragraph 5.126 does 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. [ES 5.120]

5.131 **The firm shall not undertake an engagement to 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 audit or other public interest assurance engagement by the firm.** [ES 5.121, ESRA 3.59]

5.132 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. [ES 5.122]

5.133 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 audit or other public interest assurance engagement. [ES 5.123]

- 5.134 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement. [ES 5.124]
- 5.135 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 1.59 to 1.69). [ES 5.125]

Corporate Finance Services

- 5.136 The range of services encompassed by the term 'corporate finance services' is wide. For example, the firm may be engaged:
- 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. [ES 5.126]
- 5.137 The potential for the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement 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. [ES 5.127]
- 5.138 When providing corporate finance services to an entity relevant to an audit or other public interest assurance engagement by the firm, there is a risk that the firm undertakes a management role, unless the firm is working with informed management. Appropriate safeguards are applied to reduce the self-review threat to a level where independence is not compromised. [ES 5.128]
- 5.139 Examples of safeguards that may be appropriate when corporate finance services are provided to an entity relevant to an audit or other public interest assurance engagement by the firm, include ensuring that:

- the corporate finance advice is provided by partners and staff who have no involvement in the audit or other public interest assurance 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 audit or other public interest assurance engagement reviews the engagement work performed in relation to the subject matter of the corporate finance services provided to ensure that such audit or other public interest assurance engagement work has been properly and effectively reviewed and assessed in the context of the audit or other public interest assurance engagement. [ES 5.129]

5.140 Where the firm undertakes an engagement to provide corporate finance services to an entity relevant to an audit or other public interest assurance engagement by the firm in connection with conducting the sale or purchase of a material part of the entity's business, the engagement partner for the audit or other public interest assurance engagement informs the audit committee (or equivalent) and, where applicable, any other person or entity the firm is instructed to advise, about the engagement, as set out in paragraphs 1.59 to 1.69 of Section 1 of this Ethical Standard. [ES 5.130, ESRA 3.68]

5.141 **The firm shall not undertake an engagement to provide corporate finance services in respect of an entity relevant to an audit or other public interest assurance engagement by the firm, where:**

- (a) **the engagement would involve the firm taking responsibility for dealing in, underwriting, or promoting shares; or**
- (b) **the engagement partner for the audit or other public interest assurance engagement 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 being audited, or in other subject matter information or subject matter in the case of an other public interest assurance engagement, and upon which the success of the related transaction depends:**
 - (i) **is based on well-established interpretations; or**
 - (ii) **in the case of an audit, is appropriate, having regard to the requirement for the financial statements to give a true and fair view in accordance with the relevant financial reporting framework; or**
 - (iii) **in the case of an other public interest assurance engagement, is appropriate having regard to the requirements of the relevant reporting framework; or**
- (c) **the engagement would involve the firm undertaking a management role in the entity. [ES 5.131, ESRA 3.69]**

5.142 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. [ES 5.132]

- 5.143 Where the firm acts as a sponsor under the Listing Rules⁶, or as Nominated Adviser on the admission of the entity to the 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 such an engagement. [ES 5.133]
- 5.144 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 of the entity, which are, or will be, subject to an audit or other public interest assurance 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 entities relevant to an audit or other public interest assurance 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 audited financial statements, or in other subject matter information or subject matter in the case of an other public interest assurance engagement, of the entity and on which the success of a transaction depends is well established and appropriate. [ES 5.134]
- 5.145 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. [ES 5.135]
- 5.146 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 for the audit or other public interest assurance engagement establishes appropriate safeguards. [ES 5.136]
- 5.147 Where a corporate finance engagement is undertaken on a contingent fee basis, self-interest threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement also arise as they may have, or may appear to have, an interest in the success of the corporate finance services. The significance of the self-interest threat is primarily determined by the materiality of the contingent fee to the firm, or to the part of the firm by

⁶ In the United Kingdom, the UK Listing Authority's publication the 'Listing Rules'. In the Republic of Ireland, the United Kingdom 'Listing Rules' as modified by the 'Notes on the Listing Rules' published by the Irish Stock Exchange.

reference to which the engagement partner's profit share is calculated. Where the contingent fee and the outcome of the corporate finance services is dependent on a judgment made by the firm in relation to a material aspect of an audit or other public interest assurance engagement, the self-interest threat cannot be eliminated or reduced to an acceptable level by the application of any safeguards. [ESRA 3.74]

5.148 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 engagements in relation to the transaction on a contingent fee basis, or will not accept the investment circular reporting engagement. Where corporate finance engagements 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 engagement so that it no longer involves a contingent fee or withdraws from either the relevant corporate finance engagement or the investment circular reporting engagement. [ESRA 3.75]

5.149 Where the firm provides a range of corporate finance services to the entity(ies) relevant to the engagement, including acting as a Sponsor, Nominated Advisor or IEX Adviser on terms that involve a contingent fee, and that firm also undertakes a public reporting engagement for entity(ies) relevant to the engagement, the self-interest threat caused by contingent fee arrangements may be reduced to an acceptable level 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, the Irish Stock Exchange or the London Stock Exchange and any related regulatory requirements have been complied with. [ESRA 3.76]

Transaction Related Services

5.150 In addition to corporate finance services, there are other non-audit services associated with transactions that a firm may undertake for an entity relevant to an audit or other public interest assurance engagement by the firm. For example:

- investigations into possible acquisitions or disposals ('due diligence' investigations); or
- 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). [ES 5.137]

- 5.151 When providing transaction related services to an entity relevant to an audit or other public interest assurance engagement by the firm, there is a risk that the firm may face a management threat, unless the firm is working with informed management. Appropriate safeguards are applied to reduce the self-review threat to a level where independence is not compromised. [ES 5.138]
- 5.152 Examples of safeguards that may be appropriate when transaction related services are provided to an entity relevant to an audit or other public interest assurance engagement by the firm include ensuring that:
- the transaction related advice is provided by partners and staff who have no involvement in the audit or other public interest assurance 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 audit or other public interest assurance engagement reviews the audit or other public interest assurance 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 audit or other public interest assurance engagement. [ES 5.139]
- 5.153 **The firm shall not undertake an engagement to provide transaction related services in respect of an entity relevant to an audit or other public interest assurance engagement by the firm, where:**
- (a) **the engagement partner for the audit or other public interest assurance engagement 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 being audited, or other subject matter information or subject matter in the case of an other public interest assurance engagement, and upon which the success of the related transaction depends;**
- (i) **is based on well-established interpretations; or**
 - (ii) **in the case of an audit, is appropriate having regard to the requirement for the financial statements to give a true and fair view in accordance with the relevant financial reporting framework; or**
 - (iii) **in the case of an other public interest assurance engagement, is appropriate having regard to the requirements of the relevant reporting framework; or**
- (b) **the engagement would involve the firm undertaking a management role in the entity. [ES 5.140, ESRA 3.80]**
- 5.154 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 audit or other public interest assurance 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 entities relevant to an audit or other public interest assurance 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 in the case of an other public interest assurance engagement, of the entity and on which the success of a related transaction depends, is well established and appropriate. [ES 5.141]

5.155 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 for the audit or other public interest assurance engagement establishes appropriate safeguards. [ES 5.142]

5.156 Where a transaction related services engagement is undertaken on a contingent fee basis, self-interest threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of an audit or other public interest assurance engagement by the firm also arise as they may have, or may appear to have, an interest in the success of the transaction. The significance of the self-interest threat is primarily determined 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. Where the contingent fee and the outcome of the transaction related services is dependent on a judgment made by the firm in relation to a material aspect of an audit or other public interest assurance engagement, the self-interest threat cannot be eliminated or reduced to an acceptable level by the application of any safeguards. [ESRA 3.82]

Restructuring Services

5.157 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. [ES 5.143]

5.158 The services that an entity may engage 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 is the entity's auditor or provides an other

public interest assurance engagement for the entity, the engagement partner for the audit or other public interest assurance engagement evaluates

- the threats that the services may present to the firm's ability to conduct any contemporary or future audit or other public interest assurance 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement would be compromised. [ES 5.144]

5.159 **The firm shall not undertake an engagement to provide restructuring services in respect of an entity relevant to an audit or other public interest assurance engagement by the firm, where:**

- a. **the engagement would involve the firm undertaking a management role in or on behalf of the entity; or**
- b. **the engagement 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 in the case of an other public interest assurance engagement.** [ES 5.145]

5.160 The potential for the integrity, objectivity and independence of the firm or persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement are such that no safeguards can reduce the threat a level¹¹. [ES 5.146]

5.161 **The firm shall not undertake an engagement to provide restructuring services in respect of an entity relevant to an audit or other public interest assurance engagement by the firm, where that engagement may**

¹¹ 'ES – Provisions Available for Small Entities (Revised)' provides exemptions relating to informed management and the advocacy threat for auditors of small entities.

give rise to a self-review threat in the course of a contemporary or future audit or other public interest assurance 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. [ES 5.147]

- 5.162 The provision of restructuring services gives rise to a self-review threat where the restructuring services to be provided involve advice or judgments which are likely to be material to a contemporary or future judgment of the firm in relation to an audit or other public interest assurance engagement. [ES 5.148]
- 5.163 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. [ES 5.149]
- 5.164 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. [ES 5.150]
- 5.165 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'). [ES 5.151]
- 5.166 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 persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement 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 the engagement, or those parts of the engagement affected by those threats that cannot be addressed. [ES 5.152]

- 5.167 **Where an entity in distress relevant to an audit or other public interest assurance engagement by the firm, is a *listed entity* with a market capitalisation of more than £100 million (see paragraph 5.66), 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 audited entity;**
 - (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 audited entity. [ES5.153]**
- 5.168 Except to the extent identified in paragraph 5.167, 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* with a market capitalisation of more than £100m, 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. [ES 5.154]
- 5.169 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 1.46 of Section 1 of this Ethical Standard. [ES 5.155]

Accounting Services

- 5.170 In 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'. [ES 5.156]
- 5.171 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 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. [ES 5.157]

- 5.172 The provision of accounting services by the firm to an entity relevant to an audit or other public interest assurance engagement by the firm creates threats to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement, 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. [ES 5.158]
- 5.173 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. [ES 5.159]
- 5.174 **The firm shall not undertake an engagement to provide accounting services to:**
- (a) an entity that is a *listed entity* with a market capitalisation of more than £100 million (see paragraph 5.66), relevant to an audit or other public interest assurance engagement by the firm, or a significant affiliate of such an entity; or**
 - (b) any other entity relevant to an audit or other public interest assurance engagement by the firm, where:**
 - **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. [ES 5.160, ESRA 3.86]**
- 5.175 Even where there is no engagement 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 the audit or other public interest assurance 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 audit or other public interest assurance engagement service rather than the result of any engagement to provide non-audit / additional services. Consequently, as it is part of the audit or other public interest assurance engagement service, such advice is not regarded as giving rise to any threat to the integrity, objectivity and independence of the firm and persons in a position to influence the conduct or outcome of the audit or other public interest assurance engagement. [ES 5.161]

- 5.176 For *listed entities* with a market capitalisation of more than £100m relevant to an audit or other public interest assurance engagement by the firm, 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 undertake an engagement to provide any accounting services. [ES 5.162]

5.177 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 1.46 of Section 1 of this Ethical Standard. [ES 5.163]

5.178 For entities other than *listed entities* with a market capitalisation of more than £100m or significant affiliates of such *listed entities*, the firm may undertake an engagement to 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. [ES 5.165]

5.179 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 engagement 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. [ES 5.166]

5.180 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. [ES 5.167]

5.181 Examples of safeguards that may be appropriate when accounting services are provided to an entity relevant to an audit or other public interest assurance engagement by the firm, include:

- accounting services provided by the firm are performed by partners and staff who have no involvement in the external audit of the financial statements or other public interest assurance engagement;

- the accounting services are reviewed by a partner or other senior staff member with relevant expertise who is not a member of the audit or other public interest assurance engagement team;
- the audit or other public interest assurance engagement is reviewed by a partner with relevant expertise who is not involved in the audit or other public interest assurance engagement to ensure that the accounting services performed have been properly and effectively assessed in the context of the audit or other public interest assurance engagement. [ES 5.168]

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 services¹²	X	X
Other assurance services^{13 14}	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 ¹⁵ .	X	X

Disclosure of contingent fee arrangements under paragraph 4.22 of Section 4 of this Ethical Standard can also be facilitated through the use of a footnote to this template.

¹² This will, and will only, include those services which are identified as audit related services in paragraph 5.53 of Section 5 of this Ethical Standard.

¹³ This will not include any tax or internal audit services, all of which should be disclosed under those headings.

¹⁴ 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.

¹⁵ 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 5.7 of Section 5 of this Ethical Standard).

Disclosures required under UK company legislation¹⁶ are indicated by those categories in bold type above. Fuller information can be provided by companies if desired.

¹⁶ In the UK, SI 2011/2198 “The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) (Amendment) Regulations 2011”.

Disclosure requirements in the Republic of Ireland are set out in European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010. An information sheet on this topic “Disclosure of auditors’ remuneration” was developed by the Consultative Committee of Accountancy Bodies in Ireland and published by Chartered Accountants Ireland in January 2011: this is available at:

<http://www.charteredaccountants.ie/Members/Technical1/Financial-Reporting/Resources/Disclosure-of-Auditor-Remuneration/> .



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