Ethical Standard for Reporting Accountants

October 2006

The Auditing Practices Board

THE AUDITING PRACTICES BOARD LIMITED

The Auditing Practices Board Limited, which is part of the Financial Reporting Council, prepares for use within the United Kingdom and the Republic of Ireland:

- standards and guidance for auditing;
- standards and guidance for the work of reporting accountants in connection with investment circulars; and
- standards and guidance for auditors' and reporting accountants' integrity, objectivity and independence,

with the objective of enhancing public confidence in the audit process and the quality and relevance of audit services in the public interest.

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APB Ethical Standard for Reporting Accountants

(Issued October 2006)

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PREFACE

The APB Ethical Standard for Reporting Accountants applies to all engagements:

- that are subject to the requirements of the Standards for Investment Reporting (SIRs), and
- which are in connection with an investment circular in which a report from the reporting accountant is to be published.

It should be read in the context of the Statement "The Financial Reporting Council - Scope and Authority of Audit and Assurance Pronouncements" which sets out the application and authority of APB Ethical Standards.

The terms used in the APB Ethical Standard for Reporting Accountants are explained in the Glossary of terms at Appendix 1.

SECTION 1

INTRODUCTION

1.1 APB Ethical Standards for Auditors require an auditor to be independent from the entity that it is appointed to audit. There is a substantial degree of similarity between an audit opinion and the nature of assurance provided by accountants reporting for the purposes of an investment circular prepared in accordance with the statutory or regulatory requirements of a recognised stock exchange. Accordingly, the Auditing Practices Board (APB) believes that users of investment circulars will expect an equivalent standard of independence of reporting accountants to that required of auditors.

1.2 This standard is based on the APB Ethical Standards for Auditors and applies to all engagements:

- that are subject to the requirements of the Standards for Investment Reporting (SIRs) issued by the APB, and
- which are in connection with an investment circular in which a report from the reporting accountant is to be published.

This standard applies to all public reporting engagements undertaken in accordance with the SIRs. It also applies to all private reporting engagements that are directly linked to such public reporting engagements.

1.3 Where a private reporting engagement is undertaken, but it is not intended that the reporting accountant will issue a public report, the reporting accountant follows the ethical guidance issued by the professional accountancy body of which the reporting accountant is a member. The APB is not aware of any significant instances where the relevant parts of the ethical guidance issued by professional accountancy bodies in the UK and Ireland are more restrictive than this standard.

1.4 An investment circular is a document issued by an entity pursuant to statutory or regulatory requirements relating to securities on which it is intended that a third party should make an investment decision, including a prospectus, listing particulars, a circular to shareholders or similar document.

1.5 Public confidence in the operation of the capital markets and in the conduct of public interest entities depends, in part, upon the credibility of the opinions and reports issued by reporting accountants in connection with investment circulars. Such credibility depends on beliefs concerning the integrity, objectivity and independence of reporting accountants and the quality of work they perform. The APB establishes quality control, investment reporting[1] and ethical standards to provide a framework for the practice of reporting accountants.

1.6 **Reporting Accountants should conduct an investment circular reporting engagement with integrity, objectivity and independence.**

Integrity

1.7 Integrity is a prerequisite for all those who act in the public interest. It is essential that reporting accountants act, and are seen to act, with integrity, which requires not only honesty but a broad range of related qualities such as fairness, candour, courage, intellectual honesty and confidentiality.

1.8 It is important that the directors and management of an engagement client can rely on the reporting accountant to treat the information obtained during an engagement as confidential, unless they have authorised its disclosure, it is already known to third parties or the reporting accountant has a legal right or duty to disclose it. Without this, there is a danger that the directors and management will fail to disclose such information to the reporting accountant and that the outcome of the engagement will thereby be impaired.

Objectivity

1.9 Objectivity is a state of mind that excludes bias, prejudice and compromise and that gives fair and impartial consideration to all matters that are relevant to the task in hand, disregarding those that are not. Objectivity requires that the reporting accountant's judgment is not affected by conflicts of interests. Like integrity, objectivity is a fundamental ethical principle.

1.10 The need for reporting accountants to be objective arises from the fact that the important issues involved in an engagement are likely to relate to questions of judgment rather than to questions of fact. For example, 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 information may be misstated or misleading.

1.11 It is against this background that reporting accountants are engaged to undertake an investment circular reporting engagement. The reporting accountant's objectivity requires that it expresses an impartial opinion in the light of all the available information and its professional judgment. Objectivity also requires that the reporting accountant adopts a rigorous

[1] SIR 1000 paragraph 18 states *'In the conduct of an engagement involving an investment circular, the reporting accountant should comply with the applicable ethical standards issued by the Auditing Practices Board'.*

and robust approach and is prepared to disagree, where necessary, with the directors' judgments.

Independence

1.12 Independence is freedom from situations and relationships which make it probable that a reasonable and informed third party would conclude that objectivity either is impaired or could be impaired. Independence is related to and underpins objectivity. However, whereas objectivity is a personal behavioural characteristic concerning the reporting accountant's state of mind, independence relates to the circumstances surrounding the engagement, including the financial, employment, business and personal relationships between the reporting accountant and its engagement client and other parties who are connected with the investment circular.

1.13 The need for independence arises because, in most cases, users of the financial information and other third parties do not have all the information necessary to assess whether reporting accountants are, in fact, objective. Although reporting accountants themselves may be satisfied that their objectivity is not impaired by a particular situation, a third party may reach a different conclusion. For example, if a third party were aware that the reporting accountant had certain financial, employment, business or personal relationships with the engagement client, that individual might reasonably conclude that the reporting accountant could be subject to undue influence from the engagement client or would not be impartial or unbiased. Public confidence in the reporting accountant's objectivity could therefore suffer as a result of this perception, irrespective of whether there is any actual impairment.

1.14 Accordingly, in evaluating the likely consequences of such situations and relationships, the test to be applied is not whether the reporting accountant considers that its objectivity is impaired but whether it is probable that a reasonable and informed third party would conclude that the reporting accountant's objectivity either is impaired or is likely to be impaired. There are inherent threats to the level of independence (both actual and perceived) that the reporting accountant can achieve as a result of the influence that the board of directors and management have over its appointment and remuneration. The reporting accountant considers the application of safeguards where there are threats to their independence (both actual and perceived).

COMPLIANCE WITH ETHICAL STANDARDS

1.15 **The reporting accountant should establish policies and procedures, appropriately documented and communicated, designed to ensure that, in relation to each investment circular reporting engagement, the firm, and all those who are in a position directly to influence the conduct and outcome of the investment circular reporting engagement, act with integrity, objectivity and independence.**

1.16 For the purposes of the APB Ethical Standard for Reporting Accountants, a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement is:

(a) any person within the firm who is directly involved in the investment circular reporting engagement ('the engagement team'), including:

(i) the partners, managers and staff from assurance and other disciplines involved in the engagement (for example, taxation specialists, IT specialists, treasury management specialists, lawyers, actuaries);[2]

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[2] Where external consultants are engaged by the reporting accountant and involved in the engagement, the reporting accountant should evaluate the objectivity of the expert in accordance with paragraphs 2.53 to 2.55 of this Standard.

(ii) those who provide quality control or direct oversight of the engagement;

(b) any person within the firm who can directly influence the conduct and outcome of the investment circular reporting engagement through the provision of direct supervisory, management or other oversight of the engagement team in the context of the investment circular reporting engagement.

1.17 Because investment circulars may relate to transactions that are price sensitive and therefore confidential, the fact that a firm has been engaged to undertake an investment circular reporting engagement is likely to be known by only a limited number of individuals within the firm. For this reason, the requirements of this standard apply only to:

(a) individuals within the engagement team and those with a direct supervisory, management or other oversight responsibility for the engagement team who have actual knowledge of the investment circular reporting engagement; and

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

1.18 Compliance with the requirements regarding the reporting accountant's integrity, objectivity and independence is a responsibility of both the firm and of individual partners and professional staff. The firm establishes policies and procedures, appropriate to the size and nature of the firm, to promote and monitor compliance with those requirements by any person who is in a position directly to influence the conduct and outcome of the investment circular reporting engagement.[3]

[3] 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 historical financial information and other assurance and related services engagements*' establishes the basic principles and essential procedures in relation to a firm's responsibilities for its system of quality control for engagements in connection with an investment circular.

1.19 **The leadership of the firm should take responsibility for establishing a control environment within the firm that places adherence to ethical principles and compliance with the APB Ethical Standard for Reporting Accountants above commercial considerations.**

1.20 The leadership of the firm influences the internal culture of the organisation by its actions and by its example (‘the tone at the top’). Achieving a robust control environment requires that the leadership gives clear, consistent and frequent messages, backed up by appropriate actions, which emphasise the importance of compliance with the APB Ethical Standard for Reporting Accountants.

1.21 In order to promote a strong control environment, the firm establishes policies and procedures (including the maintenance of appropriate records) that include:

(a) reporting by partners and staff as required by the APB Ethical Standard for Reporting Accountants of particular circumstances including:
- family and other personal relationships involving an engagement client of the firm;
- financial interests in an engagement client of the firm; and
- decisions to join an engagement client;

(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 their consideration of the reporting accountant’s objectivity and independence, addressing, for example:
- financial interests in engagement clients;
- contingent fee arrangements;
- economic dependence on clients;

- the performance of other service engagements for the engagement client;

(c) a mechanism for prompt communication of possible or actual breaches of the firm's policies and procedures to the relevant engagement partners;

(d) 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;

(e) prohibiting members of the engagement team from making, or assuming responsibility for, management decisions for the engagement client;

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

(g) empowerment of staff to communicate to senior levels within the firm any issue of 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 subject to disciplinary proceedings as a result.

1.22 **Save where the circumstances contemplated in paragraph 1.24 apply, the firm should designate a partner in the firm ('the ethics partner'[4]) as having responsibility for:**

(a) the adequacy of the firm's policies and procedures relating to integrity, objectivity and independence, their compliance with the APB Ethical Standard for Reporting Accountants, and the effectiveness of their communication to partners and staff within the firm; and

(b) providing related guidance to individual partners.

[4] This individual may be the same person who is designated as the ethics partner for the purposes of the APB Ethical Standards for Auditors.

1.23 In assessing the effectiveness of the firm's communication of its policies and procedures relating to integrity, objectivity and independence, ethics partners consider whether these matters are properly covered in induction programmes, professional training and continuing professional development for all partners and staff with direct involvement in investment circular reporting engagements. 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.

1.24 In firms with three or less partners, 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 principles set out in the APB Ethical Standard for Reporting Accountants. 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 their professional body, or through discussion with a practitioner from another firm. In all cases, it is important that such discussions are documented.

1.25 To be able to discharge his or her responsibilities, the ethics partner is an individual possessing seniority, relevant experience and authority within the firm and is provided with sufficient staff support and other resources, commensurate with the size of the firm. Alternative arrangements are established to allow for:

- the provision of guidance on those engagements where the ethics partner is the engagement partner; and
- situations where the ethics partner is unavailable, for example due to illness or holidays.

1.26 Whenever a possible or actual breach of the APB Ethical Standard for Reporting Accountants, or of policies and procedures established pursuant to the requirements of the APB Ethical Standard for Reporting Accountants, 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 withdraw from the investment circular reporting engagement.

1.27 An inadvertent violation of this Standard does not necessarily call into question the firm's ability to undertake an investment circular reporting engagement, provided that:

(a) the firm has established policies and procedures that require all partners and staff 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 or member of staff that any matter which has given rise to a breach is to be addressed as soon as possible and ensures that such action is taken;
(c) safeguards, where appropriate, are applied, (for example, having another partner review the work done by the relevant partner or member of staff or removing him or her from the engagement team); and
(d) the actions taken and the rationale for them are documented.

IDENTIFICATION AND ASSESSMENT OF THREATS

1.28 Reporting accountants identify and assess the circumstances, which could adversely affect their objectivity ('threats'), including any perceived loss of independence, and apply 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 engagement client); or

(b) reduce the threat to an acceptable level; that is a level at which it is not probable that a reasonable and informed third party would conclude that the reporting accountant's objectivity is impaired or is likely to be impaired (for example, by having the work reviewed by another partner or by another firm).

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

Threats to objectivity and independence

1.29 The principal types of threats to the reporting accountant's objectivity and independence are:

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

1.30 A **self-interest threat** arises when reporting accountants 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 directly to influence the conduct or outcome of the engagement (for example, when the engagement partner has a financial interest in the company issuing the investment circular).

1.31 A **self-review threat** arises when the results of a service performed by the engagement team or others within the firm are reflected in the amounts included or disclosed in the financial information that is the subject of the investment circular reporting engagement (for example, when reporting in relation to an initial public offering for a company where the firm has been involved in maintaining the accounting records of that company). A threat to objectivity arises because, in the course of the investment circular reporting engagement, the reporting accountant may need to re-evaluate the work performed in the course of the other service previously provided by the firm. As, by virtue of providing the other service, the firm is associated with aspects of the financial information being reported upon, the reporting accountant may be (or may be perceived to be) unable to take an impartial view of relevant aspects of that financial information.

1.32 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.

1.33 In assessing the significance of the self-review threat in relation to an investment circular reporting engagement, the reporting accountant considers the extent to which the other service will:

- involve a significant degree of subjective judgment; and
- have a material effect on the preparation and presentation of the financial information that is the subject of the investment circular reporting engagement.

1.34 Where a significant degree of subjective judgment relating to the financial information is involved in an other service engagement, the reporting accountant may be inhibited from questioning that judgment in the course of the investment circular reporting engagement. Whether a significant degree of subjective judgment is involved will depend upon whether the other service involves the application of well-established principles and procedures, and whether reliable information is available. If such circumstances do not exist because the other service is based on concepts, methodologies or assumptions that require judgment and are not established by the engagement client or by authoritative guidance, the reporting accountant's objectivity and the appearance of its independence may be adversely affected. Where the provision of the other service during the relevant period also has a material effect on the financial information that is the subject of the investment circular reporting engagement, it is unlikely that any safeguard can eliminate or reduce to an acceptable level the self-review threat.

1.35 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 (the engagement client) 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).

A threat to objectivity and independence arises because, by making judgments and taking decisions that are properly the responsibility of management, the firm erodes the distinction between the engagement client and the reporting accountant. The firm may become closely aligned with the views and interests of management and this may, in turn, impair or call into question the reporting accountant's ability to apply a proper degree of professional scepticism in performing the investment circular reporting engagement. The reporting accountant's objectivity and independence therefore may be impaired, or may be perceived to be, impaired.

1.36 Factors to be considered in determining whether an other service does or does not give rise to a management threat include whether:

- the other service results in recommendations by the firm justified by objective and transparent analyses or the engagement client being given the opportunity to decide between reasonable alternatives;
- the reporting accountant is satisfied that a member of management (or senior employee) has been designated by the engagement client to receive the results of the other service and make any judgments and decisions that are needed; and
- that member of management has the capability to make independent management judgments and decisions on the basis of the information provided ('informed management').

1.37 Where there is 'informed management', the reporting accountant assesses whether there are safeguards that can be introduced that would be effective to avoid a management threat or to reduce it to a level at which it can be disregarded. Such safeguards would include the investment circular reporting engagement being provided by partners and staff who have no involvement in those other services. In the absence of 'informed management', it is unlikely that any safeguards can eliminate the management threat or reduce it to an acceptable level.

1.38 An **advocacy threat** arises when the firm undertakes work that involves acting as an advocate for an engagement client and supporting a position taken by management in an adversarial context (for example, by 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 reporting accountant's objectivity and independence. For example, where the firm, acting as advocate, has supported a particular contention of management, it may be difficult for the reporting accountant to take an impartial view of this in the context of its review of the financial information.

1.39 Where the provision of an other service would require the reporting accountant to act as an advocate for the engagement client in relation to matters that are material to the financial information that is the subject of the investment circular reporting engagement, it is unlikely that any safeguards can eliminate or reduce to an acceptable level the advocacy threat that would exist.

1.40 A **familiarity threat** arises when reporting accountants are predisposed to accept or are insufficiently questioning of the engagement client's point of view (for example, where they develop close personal relationships with client personnel through long association with the engagement client).

1.41 An **intimidation threat** arises when the conduct of reporting accountants is influenced by fear or threats (for example, where they encounter an aggressive and dominating party).

1.42 These categories may not be entirely distinct: 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 client, but encounters an aggressive and dominating individual, there may be a self-interest threat as well as an intimidation threat.

1.43 When identifying threats to objectivity and independence, reporting accountants consider circumstances and relationships with a number of different parties. The engagement client may constitute one or more parties, dependent on the circumstances of the transaction which is the subject of the investment circular[5]. 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 1.44 as necessary.

1.44 Where either:

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

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 client and its significant affiliates. In such instances the reporting accountant undertakes those enquiries[6] that are practical in the time available into the relationships and other service engagements that the firm has with the non-audit client 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 client that a consideration of all known threats has been undertaken and, where appropriate, safeguards applied, but this does not constitute a full

[5] 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.

[6] 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.

evaluation of all relationships and other services provided to the non-audit client.

1.45 **The firm should establish policies and procedures to require persons in a position directly to influence the conduct and outcome of the investment circular reporting engagement to be constantly alert to circumstances and relationships with:**

(a) the engagement client, and

(b) other parties who are connected with the investment circular,

that might reasonably be considered threats to their objectivity or the perceived loss of their independence, and, where such circumstances or relationships are identified, to report them to the engagement partner or to the ethics partner, as appropriate.

1.46 Such policies and procedures require that threats to the reporting accountant's objectivity and independence are communicated to the appropriate person, having regard to the nature of the threats and the part of the firm and the identity of any person involved. The consideration of all threats and the action taken is documented. If the engagement partner is personally involved, or if he or she is unsure about the action to be taken, the matter is resolved through consultation with the ethics partner.

1.47 In addition to considering independence in the context of the engagement client, 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.[7] The reporting accountant considers the circumstances involved and uses judgment to assess whether it is probable that a reasonable and informed third party would conclude that the reporting accountant's objectivity either is impaired or is likely to be impaired as a result of relationships held with any of these parties.

1.48 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. These relationships will not generally give rise to a significant threat to the reporting accountant's objectivity.

1.49 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 party are more likely to give rise to a significant threat to the reporting accountant's objectivity. Consideration of the threats to the reporting accountant's 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

[7] 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.

- large direct financial interests in, or loans made by, the other party.

1.50 **The firm should establish policies and procedures to require the engagement partner to identify and assess the significance of threats to the reporting accountant's objectivity, including any perceived loss of independence:**

(a) when considering whether to accept an investment circular reporting engagement and planning the work to be undertaken;

(b) when signing the report;

(c) when considering whether the firm can accept or retain an engagement to provide other services to an engagement client during the relevant period; and

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

1.51 An initial assessment of the threats to objectivity and independence is required when the engagement partner is considering whether to accept an investment circular reporting engagement and planning the engagement. At the end of the engagement, when reporting on the work undertaken but before issuing the report, the engagement partner draws an overall conclusion as to whether any threats to objectivity and independence have been properly addressed in accordance with the APB Ethical Standard for Reporting Accountants. If, at any time, the reporting accountant is invited to accept an engagement to provide other services to an engagement client for which the firm is undertaking an investment circular reporting engagement, the engagement partner considers the impact this new engagement may have on the reporting accountant's objectivity and independence.

1.52 When identifying and assessing threats to their objectivity and independence, reporting accountants take into account their current relationships with the engagement client (including other service engagements) and those that existed prior to the current engagement in the relevant period. The relevant period covers the period during which the engagement is undertaken and any additional period before the engagement period but subsequent to the balance sheet date of the most recent audited financial statements[8]. This is because those prior relationships may be perceived as likely to influence the reporting accountant in the performance of the investment circular reporting engagement or as otherwise impairing the reporting accountant's objectivity and independence.

1.53 A firm's procedures will include reference to records of past and current engagements whenever a new investment circular reporting engagement is proposed.

1.54 Where the engagement client or a third party calls into question the objectivity and independence of the firm in relation to a particular client, the ethics partner carries out such investigations as may be appropriate.

IDENTIFICATION AND ASSESSMENT OF SAFEGUARDS

1.55 **If the engagement partner identifies threats to the reporting accountant's objectivity, including any perceived loss of independence, he or she should identify and assess the effectiveness of the available safeguards and apply such safeguards as are sufficient to eliminate the threats or reduce them to an acceptable level.**

1.56 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.

[8] 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.

1.57 Sections 2 and 3 of this Standard address specific circumstances which can create threats to the reporting accountant's objectivity or loss of independence. They give examples of safeguards that can, in some circumstances, eliminate the threat or reduce it to an acceptable level. In circumstances where this is not possible, either the reporting accountant does not accept (or withdraws from) the investment circular reporting engagement or, in the case of threats arising from the current provision of other services, does not undertake the engagement to provide the other service.

1.58 **The engagement partner should not accept or should not continue an investment circular reporting engagement if he or she concludes that any threats to the reporting accountant's objectivity and independence cannot be reduced to an acceptable level.**

1.59 If during the conduct of the investment circular reporting engagement the engagement partner becomes aware of a threat and concludes that it cannot be reduced to an acceptable level, the firm withdraws immediately from the engagement, save in circumstances where a reasonable and informed third party would regard ceasing to act as the reporting accountant would be contrary to the public interest. In such cases withdrawal from the investment circular reporting engagement may not be appropriate. The firm discloses on a timely basis full details of the position to those charged with governance of the issuing engagement client and those the reporting accountant is instructed to advise, as set out in paragraphs 1.68 to 1.76, and establishes appropriate safeguards.

ENGAGEMENT QUALITY CONTROL REVIEW

1.60 Paragraph 22 of SIR 1000 requires the reporting accountant to comply with applicable standards and guidance set out in ISQC (UK and Ireland) 1 *'Quality control for firms that perform audits and reviews of historical financial information and other assurance and related services engagements'* and ISA (UK and Ireland) 220 *'Quality control for audits of historical financial information'*. This includes the appointment of an engagement quality control reviewer for all public reporting engagements.

1.61 **The engagement quality control reviewer should:**

(a) consider the firm's compliance with the APB Ethical Standard for Reporting Accountants in relation to the investment circular reporting engagement;

(b) form an independent opinion as to the appropriateness and adequacy of the safeguards applied; and

(c) consider the adequacy of the documentation of the engagement partner's consideration of the reporting accountant's objectivity and independence.

1.62 The requirements of paragraph 1.61 supplement the requirements relating to the engagement quality control review established by ISA (UK and Ireland) 220. The engagement quality control reviewer will be a partner or other person performing the function of a partner who is not otherwise involved in the engagement. The experience required of the engagement quality control reviewer is determined by the nature of the engagement and the seniority and experience of the engagement partner.

OVERALL CONCLUSION

1.63 **At the end of the investment circular reporting engagement, when reporting on the work undertaken but before issuing the report, the engagement partner should reach an overall conclusion that any threats to objectivity and independence have been properly addressed in accordance with the APB Ethical Standard for Reporting Accountants. If the engagement partner cannot make such a conclusion, he or she should not report and the firm should withdraw from the investment circular reporting engagement.**

1.64 If the engagement partner remains unable to conclude that any threat to objectivity and independence has been properly addressed in accordance with the APB Ethical Standard for Reporting Accountants, or if there is a disagreement between the engagement partner and the engagement quality control reviewer, he or she consults the ethics partner.

1.65 In concluding on compliance with the requirements for 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.

OTHER ACCOUNTANTS INVOLVED IN AN INVESTMENT CIRCULAR REPORTING ENGAGEMENT

1.66 **The engagement partner should be satisfied that other accountants (whether a network firm or another firm) involved in the investment circular reporting engagement, who are not**

subject to the APB Ethical Standard for Reporting Accountants, are objective and document the rationale for that conclusion.

1.67 The engagement partner obtains written confirmation from the other accountants that they have a sufficient understanding of and have complied with the applicable provisions of the IFAC Code of Ethics for Professional Accountants, including the independence requirements.[9]

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

1.68 **The engagement partner should ensure that those charged with governance of the issuing engagement client, and any other persons or entities the reporting accountant is instructed to advise, are appropriately informed on a timely basis of all significant facts and matters that bear upon the reporting accountant's objectivity and independence.**

1.69 Those charged with governance of the issuing engagement client are responsible for oversight of the relationship between the reporting accountant and the entity and of the conduct of the investment circular reporting engagement. This group therefore has a particular interest in being informed about the reporting accountant's ability to report objectively on the engagement.

[9] The International Federation of Accountants Code of Ethics for Professional Accountants (the IFAC Code) establishes a conceptual framework for ethical requirements for professional accountants and includes independence requirements for assurance engagements. No Member Body of IFAC is allowed to apply less stringent standards than those stated in the IFAC Code. In addition, members of the IFAC Forum of Firms have agreed to apply ethical standards, which are at least as rigorous as those of the IFAC Code.

1.70 The aim of these communications by the reporting accountant is to ensure full and fair disclosure to those charged with governance of the issuing engagement client and to those from whom, in accordance with the engagement letter, the reporting accountant takes instructions of matters in which they have an interest.

1.71 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 reporting accountant's objectivity and independence. In other cases, however, the parties to the engagement letter (other than the engagement client) 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 reporting accountant 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, the reporting accountant will make disclosures to all those from whom, in accordance with the engagement letter, the reporting accountant takes instructions.

1.72 Matters communicated will generally include the key elements of the engagement partner's consideration of objectivity and independence, such as:

- the principal threats, if any, to objectivity and independence identified by the reporting accountant, including consideration of relationships between the firm and:
  - the engagement client, its affiliates and directors, and
  - the sponsor and such other parties from whom the reporting accountant takes instructions, and
  - other entities directly involved in the transaction which is the subject of the investment circular;
- any safeguards adopted and the reasons why they are considered to be effective;
- the considerations of the engagement quality control review;

- the overall assessment of threats and safeguards;
- information about the general policies and processes within the firm for maintaining objectivity and independence.

1.73 The reporting accountant, as a minimum:

(a) discloses in writing to those charged with governance of the issuing engagement client, and any other persons or entities the reporting accountant is instructed to advise:

(i) details of all relationships that the reporting accountant considers may reasonably be thought to bear on the objectivity and independence of the reporting accountant,[10] having regard to its relationships with the engagement client, its directors and senior management and its affiliates;

(ii) details of all relationships that the reporting accountant considers give rise to a threat to its objectivity between the reporting accountant and:

- the sponsor and such other parties from whom the reporting accountant takes instructions[11];
- other entities directly involved in the transaction which is the subject of the investment circular;

(iii) whether the total amount of fees that the reporting accountant is likely to charge to the engagement client and its significant affiliates for the provision of services relating to the transaction which is the subject of the investment circular during the relevant

[10] Relationships include significant services previously provided by the firm and network firms involved in the investment circular reporting engagement to the engagement client and its significant affiliates. In considering the significance of such services the reporting accountant takes into account whether those services have been the subject of independent review after they were provided.

[11] Where a party to the engagement letter is an established financial institution or adviser, a generic disclosure that the firm has extensive relationships entered into in the ordinary course of business with these parties is sufficient with specific disclosure only being made in the case of relationships which are outside the ordinary course of business or which are material to any party.

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

(iv) the related safeguards that are in place;

(b) confirms in writing that:

(i) it complies with the APB Ethical Standard for Reporting Accountants and that it is independent and its objectivity is not compromised, and

(ii) where relevant, the circumstances contemplated in paragraph 1.44 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.

1.74 The reporting accountant seeks to discuss these matters with those charged with governance of the issuing engagement client and those others the reporting accountant is instructed to advise.

1.75 The most appropriate time for final confirmation of such matters is usually at the conclusion of the investment circular reporting engagement. However, communications between the reporting accountant and those charged with governance of the issuing engagement client and those others the reporting accountant is instructed to advise will also be needed at the planning stage and whenever significant judgments are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide other services.

1.76 Transparency is a key element in addressing the issues raised by the provision of other services by reporting accountants to their clients. This can be facilitated by timely communication with those charged with governance of the issuing engagement client. In the case of companies that are seeking a listing, ensuring that the audit committee is properly informed about the issues associated with the provision of other services will assist the audit committee to comply on an ongoing basis with the provisions of the Combined Code on Corporate Governance[12] relating to reviewing and monitoring the external auditors' independence and objectivity.

DOCUMENTATION

1.77 **The engagement partner should ensure that his or her consideration of the reporting accountant's objectivity and independence is appropriately documented on a timely basis.**

1.78 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 reporting accountant's objectivity and independence was properly performed and provides the basis for the engagement quality control review.

1.79 Matters to be documented include all key elements of the process and any significant judgments concerning:

- threats identified (in relation to the engagement client, 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) and the process used in identifying them;
- safeguards adopted and the reasons why they are considered to be effective;
- the engagement quality control review;

[12] Provision C.3.2 provides that 'the main role and responsibilities of the audit committee should be set out in written terms of reference and should include … to develop and implement a policy on the engagement of the external auditor to supply non-audit services …'

- overall assessment of threats and safeguards; and
- communication with those charged with governance of the issuing engagement client and those others the reporting accountant is instructed to advise.

SECTION 2 - SPECIFIC CIRCUMSTANCES CREATING THREATS TO A REPORTING ACCOUNTANT'S OBJECTIVITY AND INDEPENDENCE

INTRODUCTION

2.1 Paragraphs 1.50 and 1.55 require the engagement partner to identify and assess the circumstances which could adversely affect the reporting accountant's objectivity ('threats'), including any perceived loss of independence, and to apply procedures ('safeguards') which will either:

(a) eliminate the threat; or

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

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

2.2 This section of the APB Ethical Standard for Reporting Accountants provides requirements and guidance on specific circumstances arising out of relationships with the engagement client, which may create threats to the reporting accountant's objectivity or a perceived loss of independence. It gives examples of safeguards that can, in some circumstances, eliminate the threat or reduce it to an acceptable level. In circumstances where this is not possible, either the relationship in question is not entered into or the reporting accountant either does not accept or withdraws from the investment circular reporting engagement, as appropriate.

FINANCIAL RELATIONSHIPS

General considerations

2.3 A financial interest is an interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such an interest.

2.4 Financial interests may be:

(a) owned directly, rather than through intermediaries (a 'direct financial interest'); or

(b) owned through intermediaries, for example, an open ended investment company or a pension scheme (an 'indirect financial interest').

2.5 **Where a firm is engaged to undertake an investment circular reporting engagement for a client, the firm, a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement or an immediate family member of such a person should not hold during the engagement period:**

(a) any direct financial interest in the engagement client or an affiliate of the engagement client; or

(b) any indirect financial interest in the engagement client or an affiliate of the engagement client, where the investment is material to the firm or the individual and to the intermediary; or

(c) any indirect financial interest in the engagement client or an affiliate of the engagement client, where the person holding it has both:

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

(ii) actual knowledge of the existence of the underlying investment in the engagement client.

2.6 The threats to the reporting accountant's objectivity and independence, where a direct financial interest or a material indirect financial interest in the engagement client is held by the firm or by one of the individuals specified in paragraph 2.5 are such that no safeguards can eliminate them or reduce them to an acceptable level. If the existence of the transaction which is connected with the investment circular is price sensitive information then disposal of the financial interest may not be possible and the firm either does not accept the engagement or the relevant individuals are not included in the engagement team. Where a partner with one of the financial interests specified normally has direct supervisory or management responsibility over the engagement team, he or she is excluded from this responsibility for the purposes of the particular investment circular reporting engagement.

2.7 Where one of the financial interests specified in paragraph 2.5 is held by:

(a) *the firm:* the entire financial interest is disposed of, a sufficient amount of an indirect financial interest is disposed of so that the remaining interest is no longer material, or the firm does not accept (or withdraws from) the investment circular reporting engagement;

(b) *a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement:* the entire financial interest is disposed of, a sufficient amount of an indirect financial interest is disposed of so that the remaining interest is no longer material, or that person does not retain a position in which they exert such direct influence on the investment circular reporting engagement;

(c) *an immediate family member of a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement:* the entire financial interest is disposed of, a sufficient amount of an indirect financial interest is disposed of so that the remaining interest is no longer material, or the person in a position directly to influence the conduct and outcome of the investment circular reporting engagement does not retain a position in which they exert such direct influence on the investment circular reporting engagement.

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

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

(b) actual knowledge of the existence of the underlying investment in the engagement client,

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

2.9 Where the firm or one of the individuals specified in paragraph 2.5 holds a beneficial interest in a properly operated 'blind' trust, they are (by definition) completely unaware of the identity of the underlying investments. If these include an investment in the engagement client, this means that they are unaware of the existence of an indirect financial interest. In these circumstances, there is no threat to the reporting accountant's objectivity and independence.

2.10 **Where a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement becomes aware that a close family member holds one of the financial interests specified in paragraph 2.5, that individual should 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 should resolve the matter through consultation with the ethics partner.**

Financial interests held as trustee

2.11 Where a direct or an indirect financial interest in the engagement client or its affiliates is held in a trustee capacity by a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement, or an immediate family member of such a person, a self-interest threat may be created because either the existence of the trustee interest may influence the conduct of the investment circular reporting engagement or the trust may influence the actions of the engagement client. Accordingly, such a trustee interest is only held when:

- the relevant person is not an identified potential beneficiary of the trust; and
- the financial interest held by the trust in the engagement client is not material to the trust; and
- the trust is not able to exercise significant influence over the engagement client or an affiliate of the engagement client; and
- the relevant person does not have significant influence over the investment decisions made by the trust, in so far as they relate to the financial interest in the engagement client.

2.12 Where it is not clear whether the financial interest held by the trust in the engagement client is material to the trust or whether the trust is able to exercise significant influence over the engagement client, the financial interest is reported to the ethics partner, so that a decision can be made as to the steps that need to be taken.

Financial interests held by firm pension schemes

2.13 Where the pension scheme of a firm has a financial interest in an engagement client or its affiliates and the firm has any influence over the trustees' investment decisions (other than indirect strategic and policy decisions), the self-interest threat created is such that no safeguards can eliminate it or reduce it to an acceptable level. In other cases (for example, where the pension scheme invests through a collective investment scheme and the firm's influence is limited to investment policy decisions, such as the allocation between different categories of investment), the ethics partner considers the acceptability of the position, having regard to the materiality of the financial interest to the pension scheme.

Loans and guarantees

2.14 Where reporting accountants, persons in a position directly to influence the conduct and outcome of the investment circular reporting engagement or immediate family members of such persons:

(a) accept a loan[13] or a guarantee of their borrowings from an engagement client; or

(b) make a loan to or guarantee the borrowings of an engagement client,

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[13] For the purpose of this standard, the term 'loan' does not include ordinary trade credit arrangements or deposits placed for goods or services (see paragraph 2.20).

a self-interest threat and an intimidation threat to the reporting accountant's objectivity can be created or there may be a perceived loss of independence. No safeguards can eliminate this threat or reduce it to an acceptable level.

2.15 **The firm, persons in a position directly to influence the conduct and outcome of the investment circular reporting engagement and immediate family members of such persons should not during the engagement period have a loan outstanding to, or guarantee the borrowings of, an engagement client or its affiliates unless this represents a deposit made with a bank or similar deposit taking institution in the ordinary course of business and on normal business terms.**

2.16 **The firm should not during the engagement period have a loan from, or have its borrowings guaranteed by, the engagement client or its affiliates unless:**

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

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

(c) the loan or guarantee is not material to both the firm and the engagement client.

2.17 **Persons in a position directly to influence the conduct and outcome of the investment circular reporting engagement and immediate family members of such persons should not during the engagement period have a loan from, or have their borrowings guaranteed by, the engagement client or its affiliates unless:**

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

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

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

2.18 Loans by an engagement client that is a bank or similar institution to a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement, or an immediate family member of such a person (for example, home mortgages, bank overdrafts or car loans), do not create an unacceptable threat to objectivity and independence, provided that normal business terms apply. However, where such loans are in arrears by a significant amount, this creates an intimidation threat that is unacceptable. Where such a situation arises, the person in a position directly to influence the conduct and outcome of the investment circular reporting engagement reports the matter to the engagement partner, or to the ethics partner, as appropriate and ceases to have any involvement with the investment circular reporting engagement. The engagement partner or, where appropriate, the ethics partner considers whether any work is to be reperformed.

BUSINESS RELATIONSHIPS

2.19 A business relationship between:

(a) the firm or a person who is in a position directly to influence the conduct and outcome of the investment circular reporting engagement, or an immediate family member of such a person, and

(b) the engagement client or its affiliates, or its management

involves the two parties having a common commercial interest. Business relationships may create self-interest, advocacy or intimidation threats to the reporting accountant's objectivity and perceived loss of independence. Examples include:

- joint ventures with the engagement client or with a director, officer or other individual who performs senior managerial functions for the client;

- arrangements to combine one or more services or products of the firm with one or more services or products of the engagement client 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 engagement client's products or services, or the engagement client 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 the engagement client.

Subject to the alternative procedures outlined in paragraph 1.44, a firm will identify all business relationships entered into by the firm, persons in a position directly to influence the conduct and outcome of the investment circular reporting engagement, or an immediate family member of such a person.

2.20 **Where a firm is engaged to undertake an investment circular reporting engagement for a client, the firm, persons in a position directly to influence the conduct and outcome of the investment circular reporting engagement and immediate family members of such persons should not have business relationships with the engagement client, its management or its affiliates during the relevant period except where they:**

- **are entered into in the ordinary course of business and are clearly trivial; or**
- **involve the purchase of goods and services from the firm or the engagement client in the ordinary course of business and on an arm's length basis.**

2.21 Where a business relationship exists, that is not permitted under paragraph 2.20, and has been entered into by:

(a) *the firm:* either the relationship is terminated before the start of the relevant period or the firm does not accept (or withdraws from) the investment circular reporting engagement;

(b) *a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement:* either the relationship is terminated before the start of the relevant period or that person does not retain a position in which they exert such direct influence on the investment circular reporting engagement[14];

(c) *an immediate family member of a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement:* either the relationship is terminated before the start of the relevant period or that person does not retain a position in which they exert such direct influence on the investment circular reporting engagement[14].

2.22 **Where a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement becomes aware that a close family member has one of the business relationships specified in paragraph 2.20, that individual should 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 should resolve the matter through consultation with the ethics partner.**

2.23 Where there are doubts as to whether a transaction or series of transactions are either in the ordinary course of business or on an arm's length basis, the engagement partner reports the issue to the ethics partner, so that a decision can be made as to the appropriate action that needs to be taken to ensure that the matter is resolved.

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

2.24 **A firm should not act as reporting accountant to any entity or person able to influence the affairs of the firm or the performance of any investment circular reporting engagement undertaken by the firm.**

2.25 This prohibition applies to:

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

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

A significant ownership is one that carries the ability materially to influence the policy of an entity.[15]

EMPLOYMENT RELATIONSHIPS

MANAGEMENT ROLE WITH ENGAGEMENT CLIENT

2.26 **A firm undertaking an investment circular reporting engagement should not have as a partner or employ a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement any person who is also employed by the engagement client or its affiliates ('dual employment').**

Loan staff assignments

2.27 **A reporting accountant should not enter into an agreement with an engagement client to provide a partner or employee to work for a temporary period as if that individual were an employee of the**

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

engagement client or its affiliates (a 'loan staff assignment') during the relevant period or for a period of one year before it, unless the client:

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

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

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

2.28 Where a firm agrees to assist an engagement client by providing loan staff, threats to objectivity and independence may be created. A management threat may arise if the employee undertakes work that involves making judgments and taking decisions that are properly the responsibility of management of the engagement client in relation to the transaction or the financial information that is the subject of the investment circular reporting engagement. Thus, for example, interim management arrangements involving participation in the financial reporting function involved in producing the financial information that is the subject of the investment circular reporting engagement are not acceptable.

2.29 A self-review threat may also arise if the individual, during the loan staff assignment, is in a position directly to influence the preparation of the engagement client's financial information and then, on completion of that assignment, is assigned to the engagement team for that client.

2.30 **Where a partner or employee returns to the firm on completion of a loan staff assignment, that individual should not be given any role on an investment circular reporting engagement for the engagement client which involves a review of, or any work in relation to, any function or activity that he or she performed or supervised during that assignment.**

2.31 In considering for how long this restriction is to be observed, the need to realise the potential value to the effectiveness of the investment circular reporting engagement of the increased knowledge of the client's business gained through the assignment has to be weighed against the potential threats to objectivity and independence. Those threats increase with the length of the assignment and with the intended level of responsibility of the individual within the engagement team. As a minimum, this restriction will apply to at least the period until an audit has been undertaken of the financial statements following the completion of the loan staff assignment.

Partners and engagement team members joining an engagement client

2.32 **Where a former partner in the firm joins the engagement client, the firm should take action before any further work is done by the firm in connection with the investment circular reporting engagement to ensure that no significant connections remain between the firm and the individual.**

2.33 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.

2.34 **Reporting accountants should establish policies and procedures that require:**

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

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

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

(d) a review of the work performed by the resigning or former engagement team member in relation to the investment circular reporting engagement.

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

2.36 Where a partner in the firm or a member of the engagement team for a particular client has left the firm and taken up employment with that client, the significance of the self-interest, familiarity and intimidation threats is assessed and normally depends on such factors as:

- the position that individual had in an engagement team or the firm;

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

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

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

2.38 **Where a partner leaves the firm and is appointed as a director (including as a non-executive director) or to a key management position with an engagement client, having acted as an audit engagement partner, engagement quality control reviewer, key audit partner, reporting accountant or a partner in the chain of command at any time in the two years prior to such appointment, the firm should not accept an appointment as reporting accountant for a period of two years commencing when the former partner ceased to act for the engagement client or the former partner ceases employment with the engagement client, whichever is the sooner.**

2.39 **Where a partner (other than as specified in paragraph 2.38) or an employee joins the engagement client as a director (including as a non-executive director) or in a key management position, the firm should consider whether the composition of the engagement team is appropriate.**

2.40 In such circumstances, the firm evaluates the appropriateness of the composition of the engagement team by reference to the factors listed in paragraph 2.36 and alters or strengthens the team to address any threat to the reporting accountant's objectivity and independence that may be identified.

Family members employed by an engagement client

2.41 **Where a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement becomes aware that an immediate or close family member is employed by the engagement client in a position to exercise influence on the accounting records or financial information, that individual should either:**

(a) in the case of an immediate family member, cease to hold a position in which they exert such direct influence on the investment circular reporting engagement; or

(b) in the case of a close family member, 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 should resolve the matter in consultation with the ethics partner.

GOVERNANCE ROLE WITH ENGAGEMENT CLIENT

2.42 **A firm that undertakes an investment circular reporting engagement should not have as a partner or employ a person who during the engagement period is:**

(a) on the board of directors of the engagement client;

(b) on 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 engagement client, or

in which the engagement client holds directly or indirectly more than 20% of the voting rights.

2.43 **Where a person in a position directly to influence the conduct and outcome of the investment circular reporting engagement has an immediate or close family member who holds a position described in paragraph 2.42, the firm should take appropriate steps to ensure that the relevant person does not retain a position in which they exert direct influence on the conduct and outcome of the investment circular reporting engagement.**

EMPLOYMENT WITH FIRM

2.44 Objectivity and independence may be threatened where a former director or employee of the engagement client becomes a member of the engagement team. Self-interest, self-review and familiarity threats may be created where a member of the engagement team has to report on, for example, financial information which he or she prepared, or elements of the financial information for which he or she had responsibility, while with the client.

2.45 **Where a former director or a former employee of an engagement client, who was in a position to exert significant influence over the preparation of the financial information, joins the firm, that individual should not be assigned to a position in which he or she is able directly to influence the conduct and outcome of an investment circular reporting engagement for that client or its affiliates for a period of two years following the date of leaving the client.**

2.46 In certain circumstances, a longer period of exclusion from the engagement team may be appropriate. For example, threats to objectivity and independence may exist in relation to an investment circular reporting engagement relating to the financial information of any period which was materially affected by the work of that person whilst occupying his or her former position of influence with the engagement client. The significance of these threats depends on factors such as:

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

FAMILY AND OTHER PERSONAL RELATIONSHIPS

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

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

2.48 A distinction is made between immediate family relationships and close family relationships. Immediate family members comprise an individual's spouse (or equivalent) and dependents, whereas close family members comprise parents, non-dependent children and siblings. While an individual can usually be presumed to be aware of matters concerning his or her immediate family members and to be able to influence their behaviour, it is generally recognised that the same levels of knowledge and influence do not exist in the case of close family members.

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

2.50 **The reporting accountant should establish policies and procedures that require:**

(a) partners and professional staff to report to the firm where they become aware of any immediate family, close family and other relationships involving an engagement client of the firm and which they consider might create a threat to the reporting accountant's objectivity or a perceived loss of independence;

(b) the relevant engagement partners to be notified promptly of any immediate family, close family and other personal relationships reported by partners and other professional staff.

2.51 **The engagement partner should:**

(a) assess the threats to the reporting accountant's objectivity and independence arising from immediate family, close family and other personal relationships on the basis of the information reported to the firm;

(b) apply appropriate safeguards to eliminate the threat or reduce it to an acceptable level; and

(c) where there are unresolved matters or the need for clarification, consult with the ethics partner.

2.52 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 the reporting accountant's objectivity and independence, treating any personal relationship as if it were a family relationship.

EXTERNAL CONSULTANTS INVOLVED IN AN INVESTMENT CIRCULAR REPORTING ENGAGEMENT

2.53 Reporting accountants may employ external consultants as part of their investment circular reporting engagement. There is a risk that an expert's objectivity and independence will be impaired if the expert is related to the entity, for example by being financially dependent upon or having an investment in, the entity.

2.54 **The engagement partner should be satisfied that any external consultant engaged by the reporting accountant in the investment circular reporting engagement will be objective and document the rationale for that conclusion.**

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

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

ASSOCIATION WITH AN ENGAGEMENT CLIENT

2.56 Where partners and staff in senior positions have been part of engagement teams acting for a client on a number of audit, corporate finance or other transaction related engagements they gain a deep knowledge of the client and its operations. This association may also create close personal relationships with client personnel, which may create threats to the reporting accountant's objectivity or perceived loss of independence.

2.57 **The firm should establish policies and procedures to monitor the extent of involvement of partners and staff in senior positions where the firm acts in connection with investment circulars on a regular basis for an engagement client.**

2.58 **Where partners and staff in senior positions in the engagement team have had extensive involvement with the engagement client, the firm should assess the threats to the reporting accountant's objectivity and independence and, where the threats are other than clearly insignificant, should:**

- **disclose the engagements previously undertaken by the reporting accountant for the engagement client to those charged with governance of the issuing engagement client and any other persons or entities the reporting accountant is instructed to advise, and**
- **apply safeguards to reduce the threats to an acceptable level.**

Where appropriate safeguards cannot be applied, the firm should either not accept or withdraw from the investment circular reporting engagement as appropriate.

2.59 Where partners and staff in senior positions in the engagement team have had extensive involvement with a particular engagement client, self-interest, self-review and familiarity threats to the reporting accountant's objectivity may arise. Similarly, such circumstances may result in an actual or perceived loss of independence.

2.60 To evaluate such threats, the reporting accountant gives careful consideration to which individual is appointed as the engagement partner on an investment circular reporting engagement. This consideration will reflect the need for relevant expertise[16] as well as factors such as:

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

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

- is employed exclusively or principally on an investment circular reporting engagement that extends for a significant period of time; or
- is remunerated on the basis of the performance of a part of the firm which is substantially dependent on fees from that engagement client.

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

2.62 In order to address those threats that are identified, firms apply safeguards to reduce the threat to an acceptable level. Appropriate safeguards may include:

- appointing a partner who has no previous involvement with the engagement client as the engagement partner;
- arranging an engagement quality control review of the investment circular reporting engagement by a partner who is not involved with the client and, if relevant, is not remunerated on the basis of the performance of part of the firm which is substantially dependent on fees from that client;
- arranging an external engagement quality control review of the investment circular reporting engagement.

FEES

2.63 **The engagement partner should be satisfied and able to demonstrate that the investment circular reporting engagement has assigned to it sufficient partners and staff with appropriate time and skill to perform the investment circular reporting engagement in accordance with all applicable Investment Reporting and Ethical Standards, irrespective of the fee to be charged.**

2.64 Paragraph 2.63 is not intended to prescribe the approach to be taken by reporting accountants to the setting of fees, but rather to emphasise that there are no circumstances where the amount of the fee can justify any lack of appropriate resource or time taken to perform an investment circular reporting engagement in accordance with applicable Investment Reporting and Ethical Standards.

2.65 **An investment circular reporting engagement should not be undertaken on a contingent fee basis.**

2.66 A contingent fee basis is any arrangement made at the outset of an engagement under which a pre-determined amount or a specified commission on or percentage of any consideration or saving is payable to the firm upon the happening of a specified event or the achievement of an outcome (or alternative outcomes). Differential hourly fee rates, or arrangements under which the fee payable will be negotiated after the completion of the engagement, do not constitute contingent fee arrangements.

2.67 Contingent fee arrangements in respect of investment circular reporting engagements create self-interest threats to the reporting accountant's objectivity and independence that are so significant that they cannot be eliminated or reduced to an acceptable level by the application of any safeguards.

2.68 The fee ordinarily reflects the time spent and the skills and experience of the personnel performing the engagement in accordance with all the relevant requirements.

2.69 The basis for the calculation of the fee is agreed with the engagement client prior to the commencement of the engagement. The engagement partner explains to the engagement client that the estimated fee is based on the expected level of work required and that, if unforeseen problems are encountered, the cost of any additional work found to be necessary will be reflected in the fee actually charged. This is not a contingent fee arrangement.

2.70 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.

2.71 Where the reporting accountant is aware that the engagement client 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.

2.72 **The firm should establish policies and procedures to ensure that the engagement partner and the ethics partner are notified where others within the firm have agreed contingent fee arrangements in relation to the provision of other services to the engagement client or its affiliates.**

2.73 Contingent fee arrangements in respect of other services provided by the firm to an engagement client may create a threat to the reporting accountant's objectivity and independence. Where fees for other services are calculated on a contingent fee basis, the perception may be that the firm's interests are so closely aligned with the engagement client that it threatens the reporting accountant's objectivity and independence. 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 an unacceptable self-interest threat and the firm does not undertake such an engagement at the same time as an investment circular reporting engagement.

2.74 **Where fees for professional services from the engagement client are overdue and the amount cannot be regarded as trivial, the engagement partner, in consultation with the ethics partner, should consider whether the firm should not accept or should withdraw from the investment circular reporting engagement.**

2.75 Where fees due from an engagement client, whether for audit, investment circular reporting engagements or for other professional services, remain unpaid for a long time a self-interest threat to the reporting accountant's objectivity and independence is created because the signing of a report may enhance the firm's prospects of securing payment of such overdue fees.

2.76 Where the outstanding fees are in dispute and the amount involved is significant, the threats to the reporting accountant's objectivity and independence may be such that no safeguards can eliminate them or reduce them to an acceptable level. The engagement partner therefore considers whether the firm can continue with the investment circular reporting engagement.

2.77 Where the outstanding fees are unpaid because of exceptional circumstances (including financial distress), the engagement partner considers whether the engagement client will be able to resolve its difficulties. In deciding what action to take, the engagement partner weighs the threats to the reporting accountant's objectivity and independence if the firm were to continue with the investment circular reporting engagement, against the difficulties the engagement client would be likely to face in finding a successor, and therefore the public interest considerations, if the firm were to withdraw from the investment circular reporting engagement.

2.78 In any case where the firm does not withdraw from the investment circular reporting engagement, the engagement partner applies appropriate safeguards (such as a review by a partner who is not involved in the engagement) and notifies the ethics partner of the facts concerning the overdue fees.

THREATENED AND ACTUAL LITIGATION

2.79 **Where litigation in relation to professional services between the engagement client or its affiliates and the firm, which is other than insignificant, is already in progress, or where the engagement partner considers such litigation to be probable, the reporting accountant should either not continue with or not accept the investment circular reporting engagement.**

2.80 Where litigation actually takes place between the firm (or any person in a position directly to influence the conduct and outcome of the investment circular reporting engagement) and the engagement client, or where litigation is threatened and there is a realistic prospect of such litigation being commenced, self-interest, advocacy and intimidation threats to the reporting accountant's objectivity and independence 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 investment circular reporting engagement requires complete candour and full disclosure between the engagement client 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 reporting accountant can foresee that such a threat may arise, it informs those charged with governance of the issuing engagement client and any other persons or entities the reporting accountant is instructed to advise of its intention to withdraw from the investment circular reporting engagement.

2.81 The reporting accountant is not required to withdraw from the investment circular reporting engagement in circumstances where a reasonable and informed third party would not regard it as being in the public interest for it to do so. Such circumstances might arise, for example, where:

- the litigation was commenced as the investment circular reporting engagement was about to be completed and stakeholder interests would be adversely affected by a delay in the completion of the work (for example where the engagement relates to the restructuring of a company to avoid its imminent collapse);
- 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 reporting accountant.

GIFTS AND HOSPITALITY

2.82 **The reporting accountant, those in a position directly to influence the conduct and outcome of the investment circular reporting engagement and immediate family members of such persons should not accept gifts from the engagement client, unless the value is clearly insignificant.**

2.83 **Those in a position directly to influence the conduct and outcome of the investment circular reporting engagement and immediate family members of such persons should not accept hospitality from the engagement client, unless it is reasonable in terms of its frequency, nature and cost.**

2.84 Where gifts or hospitality are accepted from an engagement client, self-interest and familiarity threats to the reporting accountant's objectivity and independence are created. Familiarity threats also arise where gifts or hospitality are offered to an engagement client.

2.85 Gifts from the engagement client, unless their value is clearly insignificant, create threats to objectivity and independence which no safeguards can eliminate or reduce.

2.86 Hospitality is a component of many business relationships and can provide valuable opportunities for developing an understanding of the client's business and for gaining the insight on which an effective and successful working relationship depends. Therefore, the reporting accountant's objectivity and independence is not necessarily impaired as a result of accepting hospitality from the engagement client, provided it is reasonable in terms of its frequency, its nature and its cost.

2.87 **The firm should establish policies on the nature and value of gifts and hospitality that may be accepted from and offered to clients, their directors, officers and employees, and should issue guidance to assist partners and staff to comply with such policies.**

2.88 In assessing the acceptability of gifts and hospitality, the test to be applied is not whether the reporting accountant considers that its objectivity is impaired but whether it is probable that a reasonable and informed third party would conclude that it is or is likely to be impaired.

2.89 Where there is any doubt as to the acceptability of gifts or hospitality offered by the engagement client, members of the engagement team discuss the position with the engagement partner. If the cumulative amount of gifts or hospitality accepted from the engagement client appears abnormally high or there is any doubt as to the acceptability of gifts or hospitality offered to the engagement partner, or if the engagement partner has any residual doubt about the acceptability of gifts or hospitality to other individuals, the engagement partner reports the facts to the ethics partner, for further consideration regarding any action to be taken.

SECTION 3 - THE PROVISION OF OTHER SERVICES

INTRODUCTION

3.1 The provision of other services by reporting accountants to the engagement client may create threats to their objectivity or perceived loss of independence. The threats and safeguards approach set out in Section 1 sets out the general approach to be adopted by reporting accountants in relation to the provision of other services to their clients. This approach is applicable irrespective of the nature of the services, which may be in question in a given case. This Section illustrates the application of the general approach to a number of commonly provided services.

3.2 In this Standard, 'other services' comprise any engagement in which a reporting accountant provides professional services to an engagement client other than pursuant to:

(a) any investment circular reporting engagement;

(b) the audit of financial statements; and

(c) those other roles which legislation or regulation specify can be performed by the auditors of the entity (for example, considering the preliminary announcements of listed companies, complying with the procedural and reporting requirements of regulators, such as requirements relating to the audit of the client's internal controls and reports in accordance with Section 151 or 173 of the Companies Act 1985).

3.3 Where the engagement client is a member of a group, other services, for the purposes of this Standard, include:

- services provided by the firm, to the parent company or to any of its significant affiliates; and

- services provided by a network firm which is involved in the investment circular reporting engagement to the engagement client or any of its significant affiliates.

3.4 The provisions of this section apply only to those other services provided by the reporting accountant to the engagement client 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 the reporting accountant's objectivity because:

- where the reporting accountant undertook the last audit of the engagement client's financial statements and complied with the APB Ethical Standards for Auditors, the requirements applicable to the provision of other services will have been observed; or
- where the last audit of the engagement client's financial statements 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.

3.5 **The firm should establish policies and procedures, including the alternative procedures outlined in paragraph 1.44, 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 engagement client or any of that client's significant affiliates.**

3.6 The firm establishes appropriate policies and procedures to ensure that, in relation to an engagement client, any engagement to provide an other service to the client or any of its significant affiliates during the relevant period is identified so that the engagement partner can consider the implications for the reporting accountant's objectivity and independence before the investment circular reporting engagement is accepted. Such policies and procedures are likely to involve:

i) enquiries of the engagement client;
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 the client or any of its significant affiliates during the relevant period.

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

3.7 **Where the engagement partner considers that it is probable that a reasonable and informed third party would regard the objectives of an other service engagement[17] undertaken during the relevant period as being inconsistent with the objectives of the investment circular reporting engagement, the firm should not accept or withdraw from the investment circular reporting engagement.**

3.8 The objectives of engagements to provide other services vary and depend on the specific terms of the engagement. In some cases these objectives may be inconsistent with those of the investment circular reporting engagement, and, in such cases, this may give rise to a threat to the reporting accountant's objectivity and to the appearance of its independence. Firms do not undertake other service engagements during the relevant period, where the objectives of such engagements are inconsistent with the objectives of the investment circular reporting engagement, or do not accept or withdraw from the investment circular reporting engagement.

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

3.9 Similarly, in relation to a possible new investment circular reporting engagement, consideration needs to be given to recent and current engagements to provide other services by the firm to the client and whether the scope and objectives of those engagements are consistent with the proposed investment circular reporting engagement. In making this assessment, the engagement partner gives consideration to the provisions and guidance given on specific other services in paragraphs 3.13 to 3.89.

3.10 When tendering for a new investment circular reporting engagement, the firm ensures that relevant information on recent other services is drawn to the attention of those charged with governance of the issuing engagement client and any other persons or entities the reporting accountant is instructed to advise, including:

- when recent services were provided to the client;
- the materiality of those services to the proposed investment circular reporting engagement;
- whether those services would have been prohibited if the firm had been undertaking an investment circular reporting engagement at the time when they were undertaken; and
- the extent to which the outcomes of other services have been reviewed by another firm.

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

3.12 The following paragraphs provide requirements and guidance on the provision of specific other services by the reporting accountant during the relevant period to the engagement client once the assessment of threats to independence and objectivity at the time of appointment has been made.

INTERNAL AUDIT SERVICES

3.13 The range of 'internal audit services' is wide and they may not be termed as such by the engagement client. For example, the firm may be engaged:

- to outsource the engagement client's entire internal audit function; or
- to supplement the engagement client'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 engagement client on an *ad hoc* basis.

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

3.14 The main threats to the reporting accountant's objectivity and independence arising from the provision of internal audit services are the self-review threat and the management threat.

3.15 Engagements to provide internal audit services - other than those prohibited in paragraph 3.17 - may be undertaken, provided that the reporting accountant is satisfied that 'informed management'[18] has

[18] See paragraph 1.36.

been designated by the client and provided that appropriate safeguards are applied.

3.16 Examples of safeguards that may be appropriate when internal audit services are provided to an engagement client include ensuring that:

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

3.17 **The firm should not undertake an engagement to provide internal audit services to an engagement client where it is reasonably foreseeable that:**

(a) for the purposes of the investment circular reporting engagement, the reporting accountant 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 of the engagement client in relation to the transaction or the financial information that is the subject of the investment circular reporting engagement.

3.18 The self-review threat is unacceptably high where the reporting accountant cannot perform the investment circular reporting engagement without placing significant reliance on the work performed for the purposes of the internal audit services engagement. For example, the provision of internal audit services on the internal financial controls for an engagement client which is a large bank, is likely to be unacceptable as the reporting accountant is likely to place significant reliance on the work performed by the internal audit team in relation to the bank's internal financial controls.

3.19 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 can arise where the nature of the internal audit work involves the firm in taking decisions in relation to the transaction or the financial information that is the subject of the investment circular reporting engagement, as to:

- the scope and nature of the internal audit services to be provided to the engagement client, or
- the design of internal controls or implementing changes thereto.

3.20 During the course of an investment circular reporting engagement the reporting accountant may evaluate the design and test the operating effectiveness of some of the entity's internal financial controls, including the operation of any 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 (including the internal audit function) and suggestions for addressing them. This work is a by-product of the investment circular reporting engagement rather than the result of a specific engagement to provide other services and therefore does not constitute internal audit services for the purposes of this Standard.

3.21 In some circumstances, additional internal financial controls work is performed during the course of the investment circular reporting engagement in response to a specific request. Whether it is appropriate for this work to be undertaken by the firm will depend on the extent to which it gives rise to a management threat to the reporting accountant's objectivity and independence. The engagement partner reviews the scope and objectives of the proposed work and assesses the threats to which it gives rise and the safeguards available.

INFORMATION TECHNOLOGY SERVICES

3.22 Design, provision and implementation of information technology (including financial information technology) systems by firms for their clients creates threats to the reporting accountant's objectivity and independence. The principal threats are the self-review threat and the management threat.

3.23 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 information that is the subject of the investment circular reporting engagement and do not have significant reliance placed on them by the reporting accountant, may be undertaken, provided that 'informed management'[18] has been designated by the engagement client and provided that appropriate safeguards are applied.

3.24 Examples of safeguards that may be appropriate when information technology services are provided to an engagement client include ensuring that:

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

3.25 **The firm should not undertake an engagement to design, provide or implement information technology systems for an engagement client where:**

(a) the systems concerned would be important to any significant part of the accounting system or to the production of the financial information that is the subject of an investment circular reporting engagement and the reporting accountant would place significant reliance upon them as part of the investment circular reporting engagement; or

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

3.26 Where it is reasonably apparent that, having regard to the activities and size of the engagement client and the range and complexity of the system, the 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 for its expertise and has made important decisions in relation to the design or implementation of systems of internal control and financial reporting in relation to the transaction or the financial information that is the subject of the investment circular reporting engagement.

3.27 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 client's existing platform and peripherals, setting up the chart of accounts and the entry of standard data such as the client's product names and prices) is unlikely to create a level of threat to the reporting accountant's objectivity and independence that cannot be addressed through applying appropriate safeguards.

VALUATION SERVICES

3.28 **The firm should not undertake an engagement to provide a valuation to an engagement client where the valuation would both:**

(a) involve a significant degree of subjective judgment; and

(b) have a material effect on the financial information that is the subject of the investment circular reporting engagement.

3.29 The main threats to the reporting accountant's objectivity and independence arising from the provision of valuation services are the self-review threat and the management threat. 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 that may have a material effect on the financial information that is the subject of the investment circular reporting engagement.

3.30 It is usual for the reporting accountant to provide the management with accounting advice in relation to valuation matters that have come to its attention during the course of the investment circular reporting 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 Standard.

3.31 Where reporting accountants are 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 Standard.

ACTUARIAL VALUATION SERVICES

3.32 **The firm should not undertake an engagement to provide actuarial valuation services to an engagement client, unless the firm is satisfied that either:**

(a) all significant judgments, including the assumptions, are made by 'informed management'[18]; or

(b) the valuation has no material effect on the financial information that is the subject of the investment circular reporting engagement.

3.33 Actuarial valuation services are subject to the same general principles as other valuation services. Where they involve the firm in making a subjective judgment and have a material effect on the financial information that is the subject of the investment circular reporting engagement, actuarial valuations give rise to an unacceptable level of self-review threat and so may not be performed by reporting accountants for their clients.

3.34 However, in cases 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 reporting accountant's objectivity and the appearance of its independence.

TAX SERVICES

3.35 The range of activities encompassed by the term ‘tax services’ is wide. Three broad categories of tax service can be distinguished. They are where the firm:

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

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

(c) promotes tax structures or products to the engagement client, the effectiveness of which is likely to be influenced by the manner in which they are accounted for in the financial information that is the subject of the investment circular reporting 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 reporting accountant’s objectivity and independence before deciding whether to undertake an engagement to provide tax services to an engagement client.

3.36 The provision of tax services by firms to their engagement clients may give rise to a number of threats to the reporting accountant’s objectivity and independence, 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 information that is the subject of the investment circular reporting engagement, the self-review threat.

3.37 Where the firm provides advice to the engagement client on one or more specific matters at the request of the client, 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 engagement client. However, the reporting accountant may be able to adopt appropriate safeguards.

3.38 Examples of such safeguards that may be appropriate when tax services are provided to an engagement client include ensuring that:

- the tax services are provided by partners and staff who have no involvement in the investment circular reporting 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 firm are reviewed by a partner or senior staff member with appropriate expertise who is not a member of the investment circular reporting engagement team; or
- a partner not involved in the engagement reviews whether the tax work has been properly and effectively addressed in the context of the investment circular reporting engagement.

3.39 **The firm should not promote tax structures or products or undertake an engagement to provide tax advice to an engagement client where the engagement partner has, or ought to have, reasonable doubt as to the appropriateness of the related accounting treatment involved, having regard to the requirement for the financial information to give a true and fair view in the context of the relevant financial reporting framework.**

3.40 Where the firm promotes tax structures or products or undertakes an engagement to provide tax advice to the engagement client, it may be necessary to adopt an accounting treatment about which there is reasonable doubt as to its appropriateness, in order to achieve the desired result. A self-review threat arises in the course of an investment circular reporting engagement because the reporting accountant may be unable to form an impartial view of the accounting treatment to be adopted for the purposes of the proposed arrangements. Accordingly, this Standard does not permit the promotion of tax structures or products by firms to their engagement clients where, in the view of the engagement partner, after such consultation as is appropriate, the effectiveness of the tax structure or product depends on an accounting treatment about which there is reasonable doubt as to its appropriateness.

3.41 **The firm should not undertake an engagement to provide tax services to an engagement client wholly or partly on a contingent fee basis where:**

(a) the engagement fees are material to the firm or the part of the firm by reference to which the engagement partner's profit share is calculated; or

(b) the outcome of those tax services (and, therefore, the entitlement to the fee) is dependent on:

(i) the application of tax law which is uncertain or has not been established; and

(ii) a judgment made by the reporting accountant in relation to a material aspect of the investment circular reporting engagement.

3.42 Where tax services, such as advising on corporate structures and structuring transactions to achieve a particular effect, are undertaken on a contingent fee basis, self-interest threats to the reporting accountant's objectivity and independence may arise. The reporting accountant may have, or may appear to have, an interest in the success of the tax services, causing it to make a judgment about which there is reasonable doubt as to its appropriateness. Where the contingent fee is determined by the outcome of the application of tax law, which is uncertain or has not been established, and a judgment made by the reporting accountant in relation to a material aspect of the investment circular reporting engagement, the self-interest threat cannot be eliminated or reduced to an acceptable level by the application of any safeguards.

3.43 **The firm should not undertake an engagement to provide tax services to an engagement client where the engagement would involve the firm undertaking a management role for the engagement client in relation to the transaction or the financial information that is the subject of the investment circular reporting engagement.**

3.44 When providing tax services to an engagement client, there is a risk that the reporting accountant undertakes a management role, unless the firm is working with 'informed management'[18] and appropriate safeguards are applied, such as the tax services being provided by partners and staff who have no involvement in the investment circular reporting engagement.

3.45 **The firm should not undertake an engagement to provide tax services to an engagement client where this would involve acting as an advocate for the client, before an appeals tribunal or court[19] in the resolution of an issue:**

(a) that is material to the financial information that is the subject of the investment circular reporting engagement; or

(b) where the outcome of the tax issue is dependent on a judgment made by the reporting accountant in relation to a material aspect of the investment circular reporting engagement.

[19] The restriction applies to the first level of Tax Court that is independent of the tax authorities and to more authoritative bodies. In the UK this would be the General or Special Commissioners of the Inland Revenue or the VAT and Duties Tribunal.

3.46 Where the tax services to be provided by the firm include representing the client in any negotiations or proceedings involving the tax authorities, advocacy threats to the reporting accountant's objectivity and independence may arise.

3.47 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 client). In such circumstances effective safeguards may exist and the tax authorities will undertake their own review of the issues.

3.48 Where the tax authorities indicate that they are minded to reject the client'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 reporting accountant is inhibited from forming an impartial view of the treatment of the issue in the financial information that is the subject of the investment circular reporting engagement. In such circumstances, if the issue is material to the financial information or is dependent on a judgment made by the reporting accountant in relation to a material aspect of the investment circular reporting engagement, the firm discusses the matter with the engagement client and makes it clear to the engagement client 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 engagement client, or withdraw from the investment circular reporting engagement from the time when the matter is formally listed for hearing before the appeals tribunal.

3.49 The firm is not, however, precluded from having a continuing role (for example, responding to specific requests for information) for the engagement client in relation to the appeal. The firm assesses the threat associated with any continuing role in accordance with the provisions of paragraphs 3.50 to 3.52 of this Standard.

LITIGATION SUPPORT SERVICES

3.50 **The firm should not undertake an engagement to provide litigation support services to an engagement client 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 financial information that is the subject of the investment circular reporting engagement and there is a significant degree of subjectivity involved.**

3.51 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 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 information that is the subject of the investment circular reporting engagement.

3.52 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 appropriate safeguards.

LEGAL SERVICES

3.53 **The firm should not undertake an engagement to provide legal services to an engagement client where this would involve acting as the solicitor formally nominated to represent the client 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 information that is the subject of the investment circular reporting engagement.

3.54 Although the provision by reporting accountants of certain types of legal services to their clients may create advocacy, self-review and management threats, this 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 reporting accountant of the merits of the client's position when reviewing the financial information, this Standard prohibits a reporting accountant from acting as the formally nominated representative for an engagement client in the resolution of a dispute or litigation which is material to the financial information that is the subject of the investment circular reporting engagement (either in terms of the amounts recognised or disclosed in the financial information).

RECRUITMENT AND REMUNERATION SERVICES

3.55 **The firm should not undertake an engagement to provide recruitment services to an engagement client in relation to the appointment of:**

- **any director or**
- **any employee of the engagement client who will be involved in an area that is directly concerned with the transaction which is the subject of the investment circular.**

3.56 A management threat arises where firm personnel take responsibility for any decision as to who should be appointed by the engagement client. Furthermore, 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 company, 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, the firm does not undertake engagements that involve the recruitment of individuals for key management positions during the relevant period.

3.57 Where the firm has played a significant role in relation to the identification and recruitment of a senior member of management within the company, including all directors, prior to the relevant period, the engagement partner considers whether a familiarity threat exists, taking account of factors such as:

- the closeness of personal relationships between the firm's partners and staff and client personnel;
- the length of time since the recruitment of the individual in question;
- the position held by the individual at the engagement client;
- the extent of involvement that the individual will have with the transaction which is the subject of the investment circular;
- whether the individual is in a position to exercise influence on the accounting records or financial information.

Following the assessment of any such threats, appropriate safeguards are applied where necessary, such as ensuring that the engagement team does not include individuals with a close relationship to the senior member of management or who were involved in the recruitment exercise.

3.58 Recruitment services involve a specifically identifiable, and separately remunerated, engagement. Reporting accountants may contribute to an entity's recruitment process in less formal ways. The prohibition set out in paragraph 3.55 does not extend to senior members of an engagement team interviewing prospective employees of the engagement client or to the entity using information gathered by the firm, including that relating to salary surveys.

3.59 **The firm should 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 engagement client.**

3.60 The provision of advice on remuneration packages (including bonus arrangements, incentive plans and other benefits) to existing or prospective employees of the engagement client 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.

3.61 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 investment circular reporting engagement.

3.62 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'[18] 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 reporting accountant's objectivity and independence.

3.63 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 Standard relating to tax, actuarial valuations and accounting services.

CORPORATE FINANCE SERVICES

3.64 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 client’s business and provide advisory services in the course of such sales; or
- to identify possible ‘targets’ for the client to acquire; or
- to advise the client on how to fund its financing requirements, including advising on debt restructuring and securitisation programmes; or
- to act as sponsor on admission to listing on the London Stock Exchange or the Irish Stock Exchange, as Nominated Advisor on the admission of the client on the Alternative Investments Market (AIM), or as an IEX Adviser on the admission of the client to the Irish Enterprise Exchange (IEX) of the Irish Stock Exchange; or
- to act as financial adviser to client offerors or offerees in connection with public takeovers.

3.65 The potential for the reporting accountant’s objectivity and independence to be impaired through the provision of corporate finance services varies considerably depending on the precise nature of the service provided. The main threats to reporting accountant’s 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.

3.66 When providing corporate finance services to an engagement client, there is a risk that the firm undertakes a management role, unless the firm is working with ’informed management’[18] and appropriate safeguards are applied.

3.67 Examples of safeguards that may be appropriate when corporate finance services are provided to an engagement client include ensuring that:

- the corporate finance advice is provided by partners and staff who have no involvement in the investment circular reporting 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 investment circular reporting engagement or the corporate finance services reviews the work performed in the investment circular reporting engagement.

3.68 Where the firm undertakes an engagement to provide corporate finance services to an engagement client in connection with conducting the sale or purchase of a material part of the client's business, the engagement partner should inform those charged with governance of the issuing engagement client and any other person or entity the reporting accountant is instructed to advise about the engagement, as set out in paragraphs 1.68 to 1.76.

3.69 **The firm should not undertake an engagement to provide corporate finance services to an engagement client where:**

(a) the engagement would involve the firm taking responsibility for dealing in, underwriting or promoting shares; or

(b) the engagement partner has, or ought to have, reasonable doubt as to the appropriateness of an accounting treatment that is related to the advice provided, having regard to the requirement for the financial information to give a true and fair view in accordance with the relevant financial reporting framework; or

(c) such corporate finance services are to be provided on a contingent fee basis and:

(i) the engagement fees are material to the firm or the part of the firm by reference to which the engagement partner's profit share is calculated; or

(ii) the outcome of those corporate finance services (and, therefore, the entitlement to the fee) is dependent on a judgment made by the reporting accountant in relation to a material aspect of the investment circular reporting engagement[20]; or

(d) the engagement would involve the firm undertaking a management role for the engagement client in relation to the transaction or the financial information that is the subject of the investment circular reporting engagement.

3.70 An unacceptable advocacy threat arises where, in the course of providing a corporate finance service, the firm promotes the interests of the engagement client by taking responsibility for dealing in, underwriting, or promoting shares.

3.71 Where the firm acts as a Sponsor under the Listing Rules[21], or as Nominated Adviser on the admission of the engagement client to the AIM or as an IEX Adviser on the admission of the engagement client to IEX, the firm is required to confirm that the client has satisfied all applicable conditions for listing and other relevant requirements of the Listing Rules, AIM rules or IEX Rules, respectively. Where there is, or

[20] A reporting accountant judgment made in relation to a material aspect of the investment circular reporting engagement would be one which could adversely affect the successful completion of the transaction to which the investment circular relates, for example, where a reporting accountant is considering a qualification to an accountant's report as a result of a disagreement in relation to an accounting treatment which would affect revenue recognition and where a qualified opinion would be likely to render the company unsuitable for listing.

[21] In the United Kingdom, the UK Listing Authority's publication the 'Listing Rules'. In the Republic of Ireland, the Irish Stock Exchange's publication the 'Listing Rules'.

there ought to be, reasonable doubt that the firm will be able to give that confirmation, it does not enter into such an engagement.

3.72 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 information that is the subject of the investment circular reporting engagement. Where the firm provides corporate finance services, for example advice to the engagement client on financing arrangements, it may be necessary to adopt an accounting treatment about which there is reasonable doubt as to its appropriateness in order to achieve the desired result. A self-review threat is created because the reporting accountant may be unable to form an impartial view of the accounting treatment to be adopted for the purposes of the proposed arrangements. Accordingly, this Standard does not permit the provision of advice by firms to their engagement clients where there is reasonable doubt about the appropriateness of the related accounting treatments.

3.73 Advice to engagement clients on issues such as funding 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.

3.74 Where a corporate finance engagement is undertaken on a contingent fee basis, self-interest threats to the reporting accountant's objectivity and independence also arise as the reporting accountant 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 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 reporting accountant in relation to a material aspect of the investment circular reporting engagement, the self-interest threat cannot be eliminated or reduced to an acceptable level by the application of any safeguards.

3.75 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.

3.76 Where the firm provides a range of corporate finance services to the engagement client, 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 the engagement client, 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 Services Authority, the Irish Stock Exchange or the London Stock Exchange and any related regulatory requirements have been complied with.[22]

TRANSACTION RELATED SERVICES

3.77 In addition to corporate finance services, there are other services associated with transactions that a firm may undertake for an engagement client. For example:

- investigations into possible acquisitions or disposals ('due diligence' engagements); or
- investigations into the tax implications of possible acquisitions or disposals.

3.78 When providing transaction related services to an engagement client, unless the firm is working with 'informed management'[18] and appropriate safeguards are applied, there is a risk that the firm undertakes a management role.

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[22] At the date of issue:

- FSA Listing Rule 8.7.12 states that a sponsor must provide written confirmation to the UKLA that it is independent of the issuer or new applicant by way of a 'Sponsor's Confirmation of Independence' form;
- Irish Stock Exchange Listing Rule 2.2.1(2) requires that for each transaction in respect of which a firm acts as sponsor in accordance with the listing rules, the sponsor must submit to the Exchange at an early stage a confirmation of independence in the form set out in 'Schedule 1'.
- Part Two of the *AIM Nominated Adviser eligibility criteria* states that a nominated adviser may not act as both reporting accountant and nominated adviser to an AIM company unless it has satisfied the London Stock Exchange that appropriate safeguards are in place.
- Part Two of the *IEX Adviser Eligibility Criteria* states that an IEX adviser may not act as both reporting accountant and IEX adviser to an IEX company unless it has satisfied the Irish Stock Exchange that appropriate safeguards are in place.

3.79 Examples of safeguards that may be appropriate when transaction related services are provided to an engagement client include ensuring that:

- the transaction related advice is provided by partners and staff who have no involvement in the investment circular reporting 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 who is not involved in the investment circular reporting engagement reviews the 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 investment circular reporting engagement.

3.80 **The reporting accountant should not undertake an engagement to provide transaction related services to an engagement client where:**

(a) the engagement partner has, or ought to have, reasonable doubt as to the appropriateness of an accounting treatment that is related to the advice provided, having regard to the requirement for the financial information to give a true and fair view in accordance with the relevant financial reporting framework; or

(b) such transaction related services are to be provided on a contingent fee basis and:

(i) the engagement fees are material to the firm or the part of the firm by reference to which the engagement partner's profit share is calculated; or

(ii) the outcome of those transaction related services (and, therefore, the entitlement to the fee) is dependent on a judgment made by the reporting accountant in relation to a material aspect of the investment circular reporting engagement; or

(c) the engagement would involve the firm undertaking a management role for the engagement client in relation to the transaction or the financial information that is the subject of the investment circular reporting engagement.

3.81 A self-review threat arises where the outcome of the transaction related service undertaken by the firm may be material to the financial information that is the subject of the investment circular reporting engagement. Where the engagement client proposes to undertake a transaction, it may be necessary to adopt an inappropriate accounting treatment in order to achieve the desired result. A self-review threat is created if the reporting accountant undertakes transaction related services in connection with such a transaction. Accordingly, this Standard does not permit the provision of advice by firms to their engagement clients where there is reasonable doubt about the appropriateness of the accounting treatments related to the transaction advice given.

3.82 Where a transaction related services engagement is undertaken on a contingent fee basis, self-interest threats to the reporting accountant's objectivity and independence also arise as the reporting accountant 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 reporting accountant in relation to a material aspect of the investment circular reporting engagement, the self-interest threat cannot be eliminated or reduced to an acceptable level by the application of any safeguards, other than where the transaction is subject to a pre-established dispute resolution procedure.

ACCOUNTING SERVICES

3.83 In this 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 information that is then subject to review in an investment circular reporting engagement. Advice on the implementation of current and proposed accounting standards is not included in the term 'accounting services'.

3.84 The range of activities encompassed by the term 'accounting services' is wide. In some cases, the client may ask the firm to provide a complete service including maintaining all of the accounting records and the preparation of the financial information. Other common situations are:

- the firm may take over the provision of a specific accounting function on an outsourced basis (for example, payroll);
- the client maintains the accounting records, undertakes basic bookkeeping and prepares trial balance information and asks the firm to assist with the preparation of the necessary adjustments and financial information.

3.85 The provision of accounting services by the firm to the engagement client creates threats to the reporting accountant's objectivity and independence, 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 client.

3.86 **The firm should not undertake an engagement to provide accounting services in relation to the financial information that is the subject of the investment circular reporting engagement save where the circumstances contemplated in paragraph 3.89 apply.**

3.87 Even where there is no engagement to provide any accounting services, it is usual for the reporting accountant to provide the management with accounting advice on matters that have come to its attention during the course of an engagement. Such matters might typically include:

- comments on weaknesses in the accounting records and suggestions for addressing them;
- errors identified in the accounting records and in the financial information 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 investment circular reporting engagement rather than the result of any engagement to provide other services. Consequently, as it is part of the reporting accountant's engagement, such advice cannot be regarded as giving rise to any threat to the reporting accountant's objectivity and independence.

3.88 The threats to the reporting accountant's objectivity and independence that would be created are too high to allow the firm to undertake an engagement to provide any accounting services in relation to the financial information that is the subject of the investment circular reporting engagement, save where the circumstances contemplated in paragraph 3.89 apply.

3.89 In emergency situations, the firm may provide an engagement client, or a significant affiliate of such a company, with accounting services to assist the company in the timely preparation of its financial statements or information. This might arise when, due to external and unforeseeable events, the firm personnel are the only people with the necessary knowledge of the client's systems and procedures. A situation could be considered an emergency where the firm's refusal to provide these services would result in a severe burden for the client (for example, withdrawal of credit lines), or would even threaten its going concern status. In such circumstances, the firm ensures that:

(a) any staff involved in the accounting services have no involvement in the investment circular reporting engagement; and

(b) the engagement would not lead to any firm staff or partners taking decisions or making judgments which are properly the responsibility of management.

SECTION 4 - EFFECTIVE DATE

4.1 Effective for investment circular reporting engagements commencing on or after 1 April 2007.

4.2 Firms may complete investment circular reporting engagements commenced prior to 1 April 2007 in accordance with existing ethical guidance applicable to them at the time of their engagement from the relevant professional body.

4.3 Business relationships existing at 31 October 2006 that were permissible in accordance with existing ethical guidance from the relevant professional body, but are prohibited by the requirements of paragraph 2.20, may continue until 31 December 2007 provided that:

- no new contracts (or extensions of contracts) under the business relationship are entered into;
- the reporting accountant satisfies itself that there are adequate safeguards in place to reduce the threat to acceptable levels; and
- disclosure is made to those charged with governance of the issuing engagement client and those the reporting accountant is instructed to advise.

4.4 Loan staff assignments existing at 31 October 2006 that are prohibited by the requirements of paragraph 2.27, may continue until the earlier of:

(a) the completion of the specific task or the end of the contract term, where this is set out in the contract; or

(b) 31 December 2007, where a task or term is not defined,

as long as the following apply:

- the investment circular reporting engagement was permitted by existing ethical guidance from the relevant professional body;

- any safeguards required by existing ethical guidance continue to be applied;
- the need for additional safeguards is assessed, including where possible safeguards specified in section 3, and if considered necessary, those additional safeguards are applied; and
- disclosure is made to those charged with governance of the issuing engagement client and those the reporting accountant is instructed to advise.

4.5 The requirements of paragraph 2.38 in respect of employment with the engagement client do not apply if:

- the relevant person has notified an intention to join the client, or has entered into contractual arrangements, prior to 31 October 2006;
- undertaking the investment circular reporting engagement was permitted by existing ethical guidance from the relevant professional body; and
- disclosure is made to those charged with governance of the issuing engagement client and those the reporting accountant is instructed to advise.

4.6 Where compliance with the requirements of section 3 would result in an investment circular reporting engagement or other service not being supplied, other services contracted before 31 October 2006 may continue to be provided until the earlier of:

(a) the completion of the specific task or the end of the contract term, where this is set out in the contract; or

(b) 31 December 2007, where a task or term is not defined,

as long as the following apply:

- the investment circular reporting engagement was permitted by existing ethical guidance from the relevant professional body;
- any safeguards required by existing ethical guidance continue to be applied;

- the need for additional safeguards is assessed, including where possible safeguards specified in section 3, and if considered necessary, those additional safeguards are applied; and
- disclosure is made to those charged with governance of the issuing engagement client and those the reporting accountant is instructed to advise.

APPENDIX 1 - GLOSSARY OF TERMS

accounting services	The provision of services that involve the maintenance of accounting records or the preparation of financial statements or information that is then subject to review in an investment circular reporting engagement
affiliate	Any undertaking which is connected to another by means of common ownership, control or management.
audit engagement partner	The partner or other person in the firm who is responsible for the audit 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.
chain of command	All persons who have a direct supervisory, management or other oversight responsibility for the engagement team who have actual knowledge of the investment circular reporting engagement. This includes all partners, principals and shareholders who prepare, review or directly influence the performance appraisal of any partner of the engagement team as a result of their involvement with the investment circular reporting engagement.
close family	A non-dependent parent, child or sibling.

contingent fee basis Any arrangement made at the outset of an engagement under which a pre-determined amount or a specified commission on or percentage of any consideration or saving is payable to the firm upon the happening of a specified event or the achievement of an outcome (or alternative outcomes).

Differential hourly fee rates, or arrangements under which the fee payable will be negotiated after the completion of the engagement, do not constitute contingent fee arrangements.

engagement client The party responsible for issuing the investment circular containing the financial information[23] (the issuing engagement client) and, if different the party on whose financial information the firm is reporting.

engagement partner The partner or other person in the firm who is responsible for the investment circular reporting 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.

engagement period The engagement period starts when the firm accepts the investment circular reporting engagement and ends on the date of the report.

engagement team All professional personnel who are directly involved in the acceptance and performance of a particular investment circular reporting engagement. This includes those who provide quality control or direct oversight of the engagement.

[23] The financial information is described in SIR 1000 as being the 'outcome' of a reporting engagement.

ethics partner — The partner or other person in the firm having responsibility for the adequacy of the firm's policies and procedures relating to integrity, objectivity and independence, their compliance with APB Ethical Standards and the effectiveness of their communication to partners and staff within the firm and providing related guidance to individual partners.

financial interest — An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such an interest.

firm — The sole practitioner, partnership, limited liability partnership or other corporate entity engaged as a reporting accountant. For the purpose of APB Ethical Standards, the firm includes network firms in the UK and Ireland, which are controlled by the firm or its partners.

immediate family — A spouse (or equivalent) or dependent.

issuing engagement client — The party responsible for issuing the investment circular containing the financial information being reported on.

investment circular — An investment circular is a document issued by an entity pursuant to statutory or regulatory requirements relating to securities on which it is intended that a third party should make an investment decision, including a prospectus, listing particulars, a circular to shareholders or similar document.

investment circular reporting engagement — Any public or private reporting engagement in connection with an investment circular where the engagement is undertaken in accordance with Standards for Investment Reporting (SIRs).

key audit partner — An audit partner, or other person performing the function of an audit partner, of the engagement team (other than the audit engagement partner) who is involved at the group level and is responsible for key decisions or judgments on significant matters, such as on significant subsidiaries or divisions of the audit client, or on significant risk factors that relate to the audit of that client.

key management position — Any position at the engagement client which involves the responsibility for fundamental management decisions at the client (e.g. as a CEO or CFO), including an ability to influence the accounting policies and the preparation of the financial statements of the client. A key management position also arises where there are contractual and factual arrangements which in substance allow an individual to participate in exercising such a management function in a different way (e.g. via a consulting contract).

network firm — Any entity:

- (i) controlled by the firm or
- (ii) under common control, ownership or management or
- (iii) otherwise affiliated or associated with the firm through the use of a common name or through the sharing of significant common professional resources.

person in a position directly to influence the conduct and outcome of the investment circular reporting engagement:

(a) Any person who is directly involved in the investment circular reporting engagement (the engagement team), including:

(i) professional personnel from all disciplines involved in the engagement, for example, lawyers, actuaries, taxation specialists, IT specialists, treasury management specialists;

(ii) those who provide quality control or direct oversight of the engagement;

(b) Any person within the firm who can directly influence the conduct and outcome of the investment circular reporting engagement through the provision of direct supervisory, management or other oversight of the engagement team in the context of the investment circular reporting engagement.

private reporting engagement

An engagement, in connection with an investment circular, in which a reporting accountant does not express a conclusion that is published in an investment circular.

public reporting engagement

An engagement in which a reporting accountant expresses a conclusion that is published in an investment circular and which is designed to enhance the degree of confidence of the intended users of the report about the 'outcome' of the directors' evaluation or measurement of 'subject matter' (usually financial information) against 'suitable criteria'.

relevant period

The engagement period and any additional period before the engagement period but subsequent to the balance sheet date of the most recent audited financial statements of the engagement client.

reporting accountant An accountant engaged to prepare a report for inclusion in, or in connection with, an investment circular. The reporting accountant may or may not be the auditor of the entity issuing the investment circular. The term "reporting accountant" is used to describe either the engagement partner or the engagement partner's firm[24]. The reporting accountant could be a limited company or a principal employed by the company.

[24] Where the term applies to the engagement partner, it describes the responsibilities or obligations of the engagement partner. Such obligations or responsibilities may be fulfilled by either the engagement partner or another member of the engagement team.

NOTICE TO READERS