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ETHICAL STANDARD (2016)

INTEGRITY, OBJECTIVITY AND INDEPENDENCE

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PREFACE

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

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

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

Scope of this Ethical Standard

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

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

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

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

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

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

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

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

2 ‘Subject matter information’ is the outcome that results from the evaluation or measurement of ‘subject matter’ against suitable criteria. More full definitions are given in the Glossary of Terms.
In the context of an engagement, such conflicts of interest create a potential risk (threat) that the practitioner’s judgment or actions in conducting or determining the outcome of the engagement may be unduly influenced by interests other than those of the intended user (the beneficial ‘client’ under the engagement). Such other interests are potentially wide-ranging and will usually be legitimate in themselves (though they may also not be so). However, they would be objectionable in the circumstances if the practitioner is unduly influenced by them, because this may prejudice the interests of the intended users, which should be paramount.

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

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

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

**Investment Circular Reporting Engagements**

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

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

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

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

Part A of this Ethical Standard sets out the overarching principles of integrity, objectivity and independence, together with supporting ethical provisions. Together, these establish a framework, of ethical outcomes that are required
to be met by the auditor or assurance practitioner, to provide a basis for user trust and confidence in the integrity and objectivity of the practitioner in performing the engagement.

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

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

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

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

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

The ‘Third Party Test’

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

**Threats to Integrity, Objectivity and Independence**

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

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

Relevant internal conditions would include, for example, the culture, governance and management arrangements within the firm and its network firms, and their policies and practices with respect to performance, pay and promotion. These internal conditions are expressed, in the context of those responsible for the performance of the engagement, through the formal and informal relationships of influence they have with other persons within the firm, and potentially within the firm’s network, and in turn any such relationships that those other persons may have internally. Such other persons within the firm may therefore be covered persons in a position to influence the conduct or outcome of the engagement.
Relevant external relationships would include, for example: family and personal relationships of covered persons; financial, business and employment relationships of the firm or such individuals (or closely connected persons) with an entity relevant to the engagement and potentially with other entities; and relationships with an entity relevant to the engagement that arise in the performance of the engagement or other services provided to those entities. Relevant external conditions may include, for example: the culture, governance and management of the entity; long association of those performing the engagement with an entity relevant to the engagement; and economic dependence on an entity relevant to the engagement.

The EU Audit Directive and Regulation

In April 2014 the European Commission published a Directive3 amending the Statutory Audit Directive4 and a new Audit Regulation5. The Audit Directive establishes specific requirements concerning the statutory audit of annual and consolidated financial statements. The Audit Regulation establishes further specific requirements regarding the statutory audit of ‘public interest entities’ as defined by the Audit Directive (see the definitions below).

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

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

Definitions

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

Integrity, Objectivity and Independence

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

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3 Directive 2014/56/EU
4 Directive 2006/43/EC
5 Regulation 537/2014
in the public interest or is required to adhere to legal and professional responsibilities.

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

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

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

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

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

Integrity and Objectivity

**Overarching Principle**

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

**Supporting Ethical Provisions**

1.1 The senior management of the *firm* and those with direct responsibility for the management of the *firm’s* audit and other public interest assurance business shall instil the necessary culture and behaviours respectively throughout the *firm* and that business, so as to ensure that meeting the ethical outcomes of the overarching principles and supporting ethical provisions is paramount and overrides all commercial interests of the *firm*.

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

Independence

**Overarching Principle**

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

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

7 The term ‘staff’ includes any natural persons whose services are placed at the disposal or under the control of the *firm*. 
Supporting Ethical Provisions

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

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

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

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

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

(i) the firm; or where applicable any members of its network;
(ii) any of the firm’s partners or staff; or
(iii) the firm’s owners, shareholders or any other person directly or indirectly linked to the firm by control. [AD 22.1]

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

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

1.26 – 1.44 Identification and Assessment of Threats
1.45 – 1.52 Identification and Assessment of Safeguards
1.53 – 1.55 Other Firms
financial, personal, business, employment or other relationships between:
(a) the firm, any of its network firms, or any covered person, and
(b) any entity relevant to the engagement; or
(ii) unless required by law or regulation to do so, if any other condition or relationship exists;
which would compromise the independence of the firm or any covered person. [AD 22.1]

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

(a) For each such other firm, the extant version of the IESBA Code\(^8\); and

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

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

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

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\(^8\) The ‘Code of Ethics for Professional Accountants’ issued by the International Ethics Standards Board for Accountants
which could compromise the independence of the firm or any covered person.

2.7 All partners and staff of the firm and all other covered persons who become aware of any condition or relationship which could impair the independence of the firm or any covered person shall report the matter to the engagement partner (if known) or (failing that) to the firm’s Ethics Partner/Function, where applicable, or otherwise to the senior management of the firm or those with direct responsibility for the management of the firm’s audit and other public interest assurance business, at the earliest opportunity.

2.8 The firm shall have policies and procedures designed to ensure that action is taken promptly: to investigate any condition or relationship reported in accordance with supporting ethical provision 2.7, to assess whether the independence of the firm or any covered person would be compromised and, if so, to eliminate the condition or relationship or apply sufficient safeguards, to reduce threats to a level where the independence of the firm and covered persons is not compromised, or to withdraw from the engagement.

2.9 In relation to an engagement, a firm shall not:

- agree a basis for determining fees, or
- have remuneration and evaluation policies for partners and staff,

which would compromise the independence of the firm or of any covered person.

2.10 The firm, its partners and staff and any other covered person, and persons closely associated with covered persons, shall not provide or accept gifts and hospitality in relation to an engagement unless it is probable that an objective, reasonable and informed third party would consider the value thereof to be trivial or inconsequential.

2.11 The firm shall not accept or continue an engagement for an entity, unless required by law to do so, where litigation in relation to any engagement between the firm its partners or any covered person and the entity or its affiliates is already in progress, or where the engagement partner considers such litigation to be probable, and which would compromise the independence of the firm or any covered person.

2.12 The firm shall not provide any non-audit / additional services to an entity relevant to an engagement, where such

Identification and Assessment of Threats

1.45 – 1.52 Identification and Assessment of Safeguards

1.57 – 1.60 Overall Conclusion
provision would compromise the independence of the firm or any covered person.

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

Section 1 – General Requirements and Guidance

Compliance

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

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

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

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

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

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

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

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

1.6 The specific requirements in Sections 1 – 5 of Part B of this Ethical Standard are designed to assist in meeting the ethical outcomes of the overarching principles and supporting ethical provisions. However, circumstances relating
to engagements vary widely and meeting these ethical outcomes is paramount. Compliance with the specific requirements may not be sufficient to do so as they do not address all possible circumstances.

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

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

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

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

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

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9 Monitoring of compliance with ethical requirements will often be performed as part of a broader quality control process. ISQC (UK) 1 (Revised June 2016) ‘Quality Control for Firms that Perform Audits and Reviews of Financial Statements and other Assurance and Related Services Engagements’ establishes requirements in relation to a firm’s responsibilities for its system of quality control for audits.
(a) requirements for its partners and staff to report where applicable in relation to an entity relevant to an engagement by the firm:
- family and other personal relationships involving such an entity;
- financial interests in such an entity;
- decisions to join such an entity.

(b) monitoring of compliance with the firm’s policies and procedures relating to integrity, objectivity and independence. Such monitoring procedures include, on a test basis, periodic review of the engagement partners’ documentation of the consideration of the integrity, objectivity and independence of the firm, its partners and staff, addressing, for example:
- financial interests in entities relevant to an engagement by the firm;
- economic dependence on entities relevant to an engagement by the firm;
- the performance of non-audit / additional services;
- engagement partner rotation;

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

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

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

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

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

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

Ethics Partner

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

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

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

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

1.14 If differences of opinion arise between the Ethics Partner and persons consulting him or her, the firm’s policies and procedures for dealing with and resolving differences of opinion shall be followed.\(^\text{10}\).

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

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

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

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

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

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

\(^{11}\) Firms that comply with the Audit Firm Governance Code will have appointed independent non-executives who should have the majority on a body that oversees public interest matters. Other firms may also have independent non-executives.
position reached. The Ethics Partner is proactive in considering the ethical implications of developments in the business of the firm and the environment in which it operates and in providing advice and guidance to partners and staff where appropriate.

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

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

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

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

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

Breaches

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

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\(^{12}\) A ‘Responsible Individual’ is a partner or employee of the firm who is responsible for audit work and designated as such under the audit regulations of a Recognised Supervisory Body.
1.23 An inadvertent violation of this Ethical Standard does not necessarily call into question the firm’s ability to give an audit or other public interest assurance opinion, provided that:

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

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

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

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

Non-involvement in Management Decision-taking

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

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

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

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

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

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

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

Threats to Integrity, Objectivity and Independence

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

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

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

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13 For this purpose, ‘cumulative’ means all current relationships and any past completed relationships that may be expected to have a continuing relevance to the auditor's independence and consideration of the threats that might exist.
to take actions in connection with the engagement that would be adverse to such interests of the firm or any such person. For example, such interests may include holding an investment in the entity, seeking to provide additional services to the entity or needing to recover long-outstanding fees from the entity. In relation to non-audit / additional services, the main self-interest threats concern fees and economic dependence and these are addressed in Section 4 of this Ethical Standard.

- **self-review threat**

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

  In assessing the significance of the self-review threat, the persons conducting the engagement consider the extent to which the non-audit / additional service will:
  
  - involve a significant degree of subjective judgment; and
  - have a material effect on the preparation and presentation of the financial statements or other subject matter information or subject matter of the engagement.

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

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

**management threat**

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

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

- a member of management (or senior employee of the entity) has been designated by the entity to receive the results of the non-audit / additional service and has been given the authority to make any judgments and decisions of the type set out in paragraphs 1.24 and 1.25 that are needed;
- that member of management has the capability to make independent management judgments and decisions on the basis of the information provided; and
- the results of the non-audit / additional service are communicated to the entity and, where judgments or decisions are to be made by management they are supported by an objective analysis of the issues to consider and the entity is given the opportunity to decide between reasonable alternatives.
In the absence of such informed management it is unlikely that any other safeguards can eliminate a management threat or reduce it to a level where independence is not compromised.

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

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

• advocacy threat

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

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

• familiarity (or trust) threat

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

• intimidation threat

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

These categories of threat may not be entirely distinct and certain circumstances may give rise to more than one type of threat. For example, where a firm wishes to retain the fee income from a large entity relevant to an
engagement, but encounters an aggressive or dominating individual, there may be a self-interest threat as well as an intimidation threat. Furthermore, relationships with connected parties of the entity (such as an affiliate) may give rise to similar threats.

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

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

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

1.33 The firm shall establish policies and procedures to require the engagement partner to identify and assess the significance of threats to the integrity and objectivity of the firm and covered persons on an individual and cumulative\(^\text{10}\) basis, including any threats that may compromise independence:

(a) when considering whether to accept or retain an engagement;
(b) when planning the engagement;
(c) when forming an opinion and signing the report on the financial statements or other subject matter information;\(^\text{14}\)
(d) when considering whether to accept or continue to provide non-audit / additional services to an engagement by the firm; and
(e) when potential threats are reported to him or her.

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

\(^{14}\) In the case of listed entities, the auditor also assesses whether there is any threat to the auditor's integrity, objectivity or independence when discharging responsibilities in relation to preliminary announcements and when reporting on interim results.
retain an engagement does not arise, for example where responsibility for the engagement is assigned by legislation (e.g. for certain bodies in the public sector), an assessment of the threats to integrity, objectivity and independence is still undertaken. At the end of the engagement process, when forming an opinion on the financial statements or other subject matter information but before issuing the report, the engagement partner draws an overall conclusion as to whether all threats to integrity or objectivity including any that may compromise independence have been properly addressed on an individual and cumulative basis in accordance with this Ethical Standard.

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

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

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

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

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

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15 In the case of newly incorporated clients (not part of an established group of companies), where there has been no financial statement audit, this period is from the date of incorporation.
1.39 When identifying threats to integrity or objectivity including any that could impair independence, reporting accountants consider circumstances and relationships with a number of different parties. For example, the entities relevant to the engagement may constitute one or more parties, dependent on the circumstances of the transaction which is the subject of the investment circular\(^\text{16}\). Where the party responsible for issuing the investment circular is different from the party whose financial information is included in the investment circular, the reporting accountant makes an assessment of independence with respect to each of these parties, applying the alternative procedures set out in paragraph 1.40 as necessary.

1.40 Where either:

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

- the reporting accountant’s report is to be published in an investment circular issued by an entity audited by the firm but the reporting accountant’s report is on financial information relating to another entity that is not an entity audited by the firm,

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

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

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\(^{16}\) For example, where a report on a target company’s financial statements is prepared by that company’s auditors for inclusion in the acquiring company’s investment circular.

\(^{17}\) For example, these enquiries are likely to include reviewing the list of engagements recorded in the firm’s accounting systems and an enquiry of individuals within the firm who are responsible for maintaining such systems as to whether any confidentially coded engagements could be relevant.
other entities directly involved in the transaction which is the subject of the investment circular.\^18

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

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

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

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

Identification and Assessment of Safeguards

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

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

\^18 Where such entities are part of a complex group or corporate structure, the reporting accountant considers issues relating to the wider group and not just the entity directly involved in the transaction.
1.47 Other sections of this Ethical Standard address specific circumstances that can create threats to integrity or objectivity or could impair the independence of the firm or covered persons. They give examples of safeguards that can, in some circumstances, eliminate the threat or reduce it to level where it would not compromise independence. In some circumstances, the firm either does not accept or withdraws from the engagement as appropriate or, in the case of threats arising from the provision of non-audit / additional services, does not undertake or withdraws from the non-audit / additional service.

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

- **Listed entities only** (including such entities that are PIEs) other than SME listed entities: paragraphs 5.67(a), 5.74(a), 5.85(a), 5.92, 5.104(a), 5.111, 5.148, 5.155(a)
- **Listed entities only** (including SME listed entities and listed entities that are PIEs): paragraphs 3.11, 5.47
- **Listed entities** (including SME listed entities) and public interest entities: paragraphs 1.66, 3.20, 3.21, 4.25, 4.37, 4.42, 4.47

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

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

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

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

1.52 Where an objective, reasonable and informed third party would regard ceasing to act as the provider of an engagement as detrimental to the shareholders of the audited entity (or equivalent intended users of the audit or other assurance engagement report) of, or would otherwise be contrary to the public interest, then resignation may not be immediate. However, the firm discloses full details of the position to those charged with governance of the
entity and, if applicable (e.g. for an investment circular reporting engagement), other entities and persons the *firm* is instructed to advise, and establishes appropriate safeguards.

**Other Firms Involved Engagements**

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

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

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

**Engagement Quality Control Review**

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

**Overall Conclusion**

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

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

\(^{20}\) The UK Corporate Governance Code requires audit committees to develop the company’s policy on the engagement of the external auditor to supply non-audit services.
report and the firm shall resign or otherwise withdraw from the engagement unless not permitted to do so by law or regulation.

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

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

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

Communication with Those Charged With Governance

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

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

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

21 Where there is no audit committee or equivalent body, references in this Ethical Standard to communication with the audit committee are to be construed as including communication with the board of directors.
• the principal threats, if any, to integrity or objectivity including any that could impair independence identified by the firm, including consideration of all relationships between the entity, its affiliates and directors and the firm;
• any safeguards adopted and the reasons why they are considered to be effective, including any independent partner review;
• the overall assessment of threats and safeguards;
• information about the general policies and processes within the firm for maintaining integrity, objectivity and independence.

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

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

1.66 In the case of public interest entities, and listed entities, relevant to an engagement other than an investment circular reporting engagement, the engagement partner shall ensure that the audit committee is provided with:
(a) a written disclosure of relationships (including the provision of non-audit / additional services) that may bear on the integrity, objectivity or independence of the firm or covered persons. This shall have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties, and the threats to integrity or objectivity, including those that could compromise independence, that these create. It shall also detail any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable the integrity, objectivity and independence of the firm and each covered person to be assessed;
(b) details of non-audit / additional services provided and the fees charged in relation thereto;
(c) written confirmation that the firm and each covered person is independent;

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

(e) an opportunity to discuss independence issues.

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

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

(ii) disclosure of:

- all relationships that give rise to a threat to integrity or objectivity between the reporting accountant and:
  - the sponsor and such other parties from whom the reporting accountant takes instructions. Where a party to the engagement letter is an established financial institution or adviser, a generic disclosure that the firm has extensive relationships entered into in the ordinary course of business with these parties is sufficient with specific disclosure only being made in the case of relationships which are outside the ordinary course of business or which are material to any party;
  - other entities directly involved in the transaction which is the subject of the investment circular;

- whether the total amount of fees that the reporting accountant is likely to charge an entity relevant to the engagement and its significant affiliates for the provision of services relating to the transaction which is the subject of the investment circular during the relevant period is greater than 5% of the fee income of the firm in the relevant period or the part of the firm by reference to which the engagement partner’s profit share is calculated during the relevant period; and

- the related safeguards that are in place and why they are considered effective;

(iii) confirmation that the firm and each covered person is independent and, where relevant, the circumstances contemplated in paragraph 1.40 exist and that a consideration of all known threats and safeguards has been undertaken, but this does not constitute a full
1.68 The most appropriate time for these final written confirmations of independence is usually at the conclusion of the engagement.

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

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

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

**Documentation**

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

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

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

23 Paragraph 4.25 of Section 4 of Part B of this Ethical Standard requires the engagement partner to disclose to the audit committee, in writing, any contingent fee arrangements for non-audit / additional services provided by the firm or its network firms.
1.74D  Before accepting or continuing an engagement, the firm shall assess and document the following:

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

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

(a) whether he, she or it complies with the requirements of Articles 424 and 525 of this the EU Audit Regulation;
(b) whether the conditions of Article 1726 of this the EU Audit Regulation are complied with;
(c) without prejudice to Directive 2005/60/EC, the integrity of the members of the supervisory, administrative and management bodies of the public interest entity.  [AR 6.1]

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

1.77  Matters to be documented27 include all key elements of the process and any significant judgments concerning:

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

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

24 See Section 4, paragraphs 4.6R, 4.7R and 4.34R – 4.36R, of Part B of this Ethical Standard.
25 See Section 5, paragraphs 5.167R – 5.173R, of Part B of this Ethical Standard.
26 See Section 3, paragraphs 3.9, 3.10R, 3.18R, 3.19R, of Part B of this Ethical Standard.
27 The necessary working papers can be combined with those prepared pursuant to paragraph 24 of ISA (UK) 220 (Revised June 2016) ‘Quality Control for an Audit of Financial Statements’, which requires that: ‘The auditor shall include in the audit documentation conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.’  

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

Effective Date

1.78 This Ethical Standard becomes effective on 17 June 2016.

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

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

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

A ‘currently active service’ is one where the entity has already asked the firm for advice in relation to a particular matter and the firm has commenced work in relation to that matter. It does not include advice on future matters that may, for example, be provided for in an open ended engagement/contract.
Section 2 – Financial, Business, Employment and Personal Relationships

Financial Relationships

General Considerations

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

2.2 A financial interest may be:

(a) a ‘direct financial interest’, held by way of
   (i) direct ownership of the financial instrument; or
   (ii) a ‘direct beneficial interest’ – i.e. an interest held through an intermediary which is controlled by that person holding the financial interest or where that person has the ability to influence the intermediary’s investment policy.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(a) a direct financial interest; or

28 In relation to a key audit partner or other covered person, or a person closely associated with such a partner or covered person, any engagements for which the covered person is a directly involved covered person and any other engagements, in relation to which the engagement partner practices in the same office or business unit as the covered person.
(b) an indirect financial interest that is material to the firm or to the individual or to the intermediary; or

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

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

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

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

- the compensation arrangements of that closely associated person (for example, a share option scheme, where the shares have not vested); or

- a decision made, or a transaction undertaken, by an entity with whom that closely associated person has a contractual business or employment arrangement (for example, a partnership agreement);

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

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

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

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

2.9 Except where prohibited in accordance with paragraph 2.4D, for the purposes of paragraph 2.3D, where a person who is a covered person, or any partner in the firm, or any person closely associated with them, is a member or shareholder of any entity that is relevant to an engagement, as a result of the entity’s membership or equivalent requirements, the firm should ensure that
no more than the minimum number of shares necessary to comply with the requirement are held and should assess whether this financial interest is material to either the entity or the person holding the interest. Disclosure of such interests should be made to those charged with governance of such an entity, in accordance with paragraph 1.61 of Section 1 of Part B of this Ethical Standard.

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

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

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

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

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

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

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

(c) the financial interests are not held in an entity relevant to an engagement in relation to which the person joining the firm:
is a covered person; or
• works in the same part of the firm as the engagement partner for any such engagement; or
• is involved in the provision of a non-audit / additional service to any such entity or in an entity that is an affiliate of such an entity;

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

(a) the deferral of the disposal of such financial interests is approved by the Ethics Partner/Function;
(b) a record is maintained of such individuals and interests, including a description of the circumstances; and
(c) this information is communicated to the relevant engagement partner.

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

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

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

(a) the ability to influence the investment decisions of the intermediary; and
(b) actual knowledge of the existence of the underlying investment in the entity relevant to the engagement;

there may not be a significant threat to integrity or objectivity and independence. For example, where the indirect financial interest takes the form of an investment in a pension fund, the composition of the funds and the size and nature of any underlying investment in the entity may be known but
there is unlikely to be any influence on investment decisions, as the fund will generally be managed independently on a discretionary basis. In the case of an ‘index tracker’ fund, the investment in the entity is determined by the composition of the relevant index and there may be no threat to integrity or objectivity. As long as the person holding the indirect interest is not directly involved in an engagement involving the intermediary, nor able to influence the individual investment decisions of the intermediary, any threat to integrity or objectivity and any impairment of independence may be regarded as clearly insignificant.

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

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

Financial Interests Held as Trustee

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

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

2.19 Where it is not clear whether the financial interest in the entity held by the trust is material to the trust or whether the trust is able to exercise significant influence over the entity, the financial interest is reported to the Ethics Partner/Function, so that a decision can be made as to the steps that need to be taken.
2.20 A direct or an indirect financial interest in the entity or its affiliates held in a trustee capacity by the firm or by a partner in the firm who is not a covered person or a person closely associated with them, cannot be held when the firm or relevant person is an identified potential beneficiary of the trust.

Financial Interests Held by Firm Pension Schemes

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

Loans and Guarantees

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

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

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

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

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

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

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

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

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

29 For the purpose of this Ethical Standard, the term ‘loan’ does not include ordinary trade credit arrangements or deposits placed for goods or services, unless they are material to either party (see paragraph 2.29).
2.25 Covered persons and persons closely associated with them shall not accept a loan from, or have their borrowings guaranteed by, the entity relevant to the engagement, or the affiliates of such an entity, unless:

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

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

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

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

Business Relationships

2.27 A business relationship between:

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

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

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

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

Subject to the alternative procedures outlined in paragraph 1.40 of Section 1 of Part B of this Ethical standard that may be relevant to an investment circular reporting engagement, a firm will identify all business relationships entered into by the firm, covered persons, or persons closely associated with them.
2.29  **Firms, covered persons and persons closely associated with them shall not enter into business relationships with any entity relevant to the engagement, or its management or its affiliates** except where those relationships:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2.36 This prohibition applies to:

- any entity that owns any significant part of the firm, or is an affiliate of such an entity; or
- any shareholder, director or other person in a position to direct the affairs of such an entity or its affiliate.

A significant ownership is one that carries the ability to influence materially the policy of an entity.\(^{31}\)

\(^{30}\) Firms providing such services will be authorised either by the Financial Conduct Authority or by their professional accountancy body acting as a Designated Professional Body.

\(^{31}\) For companies, competition authorities have generally treated a 15% shareholding as sufficient to provide a material ability to influence policy.
Employment Relationships

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

Management Role with an Entity Relevant to an Engagement

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

Loan Staff Assignments

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

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

(b) the entity:

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

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

• making management decisions; or

• exercising discretionary authority to commit the entity to a particular position or accounting treatment.

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

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

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

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

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

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

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

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

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

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

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

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

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

(a) for all such engagements:
   (i) senior members of the engagement team to notify the firm of any situation involving their potential employment with any such entity; and
   (ii) other members of the engagement team to notify the firm of any situation involving their probable employment with any such entity;

(b) for an engagement other than an investment circular reporting engagement:
   (i) all partners in the firm to notify the firm of any situation involving their potential employment with any such entity; and
   (ii) any other employee of the firm and any other natural person whose services are placed at the disposal of or under the control of the firm, where such employee or other person is personally approved as a statutory auditor under relevant legislation within the European Union, to notify the firm of any situation involving their probable employment with any such entity;

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

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

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

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

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

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

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

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

(a) any key management position;
(b) membership of the entity’s audit committee;
(c) membership of any body performing equivalent functions to an audit committee in relation to the entity;
(d) any other position as director of the entity or, where the entity’s affairs are managed by a management body or other committee, membership of that management body or committee;

before the end of:

(a) in the case of a public interest entity, two years; and
(b) in any other case, one year;

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

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

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

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

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

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

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

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

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

33 ‘Partner’ includes any individual with authority to bind the firm with respect to the performance of a professional services engagement.

34 The timing of the audit firm’s resignation as auditor is determined in accordance with paragraph 1.52 of Section 1 of Part B of this Ethical Standard.
between the firm and the individual and consider whether the composition of the engagement team is appropriate (paragraph 2.45 also applies in the case of a former partner).

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

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

(a) in the case of a partner, within two years before acceptance of the engagement; or
(b) in the case of another person, within one year before acceptance of the engagement;

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

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

Family Members Employed by an Entity Relevant to an Engagement

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

(a) in the case of a person closely associated with them being employed by the entity in such a position, be excluded from any role in which they would be a covered person; or
(b) in the case of a close family member of a covered person who is not a person closely associated with them, or, for an engagement
other than an investment circular reporting engagement, any close family member of any partner in the firm who is not a person closely associated with them, report the matter to the engagement partner to take appropriate action. If it is a close family member of the engagement partner or if the engagement partner is in doubt as to the action to be taken, the engagement partner shall resolve the matter in consultation with the Ethics Partner/Function.

Governance Role with an Entity Relevant to an Engagement

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

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

(a) as an officer36 or member of the board of directors of an entity relevant to an engagement of the firm;

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

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

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

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

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

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

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

36 As defined in Section 1173 of the Companies Act 2006 as including a director, manager or secretary.
consult with the Ethics Partner/Function to determine whether appropriate safeguards exist. If no such safeguards exist, the firm shall withdraw from the engagement.

Employment with the Firm

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

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

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

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

Family and Other Personal Relationships

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

• the relevant person’s involvement in the engagement;
• the nature of the relationship between the relevant person and his or her family member;
• the family member’s relationship with the entity.
A distinction is made between relationships with “persons closely associated” (which include immediate family members — a spouse or equivalent and dependents), and other close family relationships (which additionally comprise any other parents, non-dependent children and siblings who are not ‘persons closely associated’). While an individual can usually be presumed to be aware of matters concerning persons closely associated with them and to be able to influence their behaviour, it is generally recognised that the same levels of knowledge and influence do not exist in the case of close family members who are not a person closely associated with them.

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

The firm shall establish policies and procedures that require:

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

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

The engagement partner shall:

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

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

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

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

External Consultants Involved in an Engagement

Firms may employ external consultants as experts as part of their engagement, for example, in an audit engagement, in order to obtain sufficient
appropriate audit evidence regarding certain financial statement assertions.\(^{37}\)

There may be threats to an expert’s integrity or objectivity and their independence may be compromised if the expert is related to any entity relevant to the engagement, for example by being financially dependent upon or having an investment in, the entity.

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

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

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

\(^{37}\) ISA (UK) 620 (Revised June 2016) ‘Using the Work of an Auditor’s Expert’ requires that the auditor shall evaluate whether the expert has the necessary objectivity.
Section 3 – Long Association with Engagements and With Entities Relevant to Engagements

General Requirements

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

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

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

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

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

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

3.4 For an investment circular reporting engagement, the firm gives careful consideration to which individual is appointed as the engagement partner on
such an engagement. This consideration will reflect the need for relevant expertise as well as factors such as:

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

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

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

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

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

(b) (i) the reasoning as to why the individual continues to participate in the engagement without any safeguards is documented; and
(ii) the facts are communicated to those charged with governance of the entity in accordance with paragraphs 1.61 – 1.71 of Section 1 of Part B of this Ethical Standard.

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

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38 Paragraph 25 of SIR 1000 requires that a partner with appropriate experience should be involved in the conduct of the work.
requirements, such as those set out in paragraph 3.11, as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

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

Public Interest Entities and Other Listed Entities

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

Audit Firm Rotation

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

Key Audit Partners and Engagement Partners\textsuperscript{40}

3.10R Save where the circumstances in paragraphs 3.14 and 3.15 apply, the key audit partners responsible for carrying out a statutory audit of a public interest entity shall cease their participation in the statutory audit of the audited entity not later than seven\textsuperscript{41} years from the date of their appointment. They shall not participate again in the statutory audit of the audited entity before three\textsuperscript{5} years have elapsed following that cessation. [AR 17.7]

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

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

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

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

\textsuperscript{39} Sections 487 and 489 of the Companies Act 2006.

\textsuperscript{40} For an audit, the engagement partner is a key audit partner.

\textsuperscript{41} The FRC has exercised the Member State option in the second sub-paragraph of Article 17.7 to set a shorter period than the default seven year period.
include responding to queries in relation to any completed engagement. This is not intended to preclude partners whose primary responsibility within a firm is to be consulted on technical or industry specific issues from providing such consultation to the engagement team or entity after a period of two years has elapsed from their ceasing to act as engagement partner, provided that such consultation is in respect of new issues or new types of transactions or events that were not previously required to be considered by that individual in the course of acting as engagement partner.

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

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

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

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

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

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

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

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

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

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

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

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

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

(c) anyone who has acted:
   (i) as an engagement quality control reviewer for a particular entity for a period of seven years, whether continuously or in aggregate, shall not participate in the engagement until a further period of five years has elapsed;
   (ii) as a key partner involved in the engagement for a particular entity for a period of seven years, whether continuously or in aggregate, shall not participate in the engagement until a further period of two years has elapsed;
   (iii) in a combination of roles as:
      • the engagement quality control reviewer,

[AR 17.7] The FRC or the Recognised Supervisory Body to whom the FRC has delegated regulatory tasks, as applicable.
• a key partner involved in the engagement, or
• the engagement partner

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

Other Partners and Staff Involved in the Engagement in Senior Positions

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

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

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

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

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

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

If such safeguards do not reduce the threats to a level where independence is not compromised, the partner or member of staff is removed from the engagement team.
Section 4 – Fees, Remuneration and Evaluation Policies, Gifts and Hospitality, Litigation

Fees

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

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

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

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

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

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

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

4.8 A contingent fee basis includes any arrangement made at the outset of an engagement under which a specified commission on or percentage of any consideration or saving is payable to the firm upon the happening of a specified event or the achievement of an outcome (or alternative outcomes). Differential hourly fee rates, or arrangements under which the fee payable will be negotiated after the completion of the engagement, or increased to cover additional work identified as necessary during the engagement, do not constitute contingent fee arrangements.
Contingent fee arrangements in respect of engagements create self-interest threats to the integrity and objectivity of the firm and covered persons that are so significant that they cannot be eliminated or reduced to a level where independence would not be compromised.

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

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.

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

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

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

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

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

In relation to tax services, the requirements of paragraph 5.85 of Section 5 of Part B of this Ethical Standard also apply.
4.15 Where non-audit / additional services are provided on a contingent fee basis, there may be a perception that the firm’s interests are so closely aligned with the entity that the integrity, objectivity and independence of the firm and covered persons could be, or be seen to be, compromised.

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

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

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

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

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

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

- the provision of such non-audit / additional services by partners and staff who have no involvement in the engagement;
- review of the engagement by a partner with relevant expertise who is not involved in the engagement to ensure that the subject matter of the non-audit / additional service has been properly and effectively addressed in the context of the engagement.

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

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

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

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

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

### 4.26
In the case of a group engagement of a public interest entity or of an other listed entity, which involves other firms, the letter of instruction sent by the group engagement partner to the other firms requests disclosure of any
contingent fees for non-audit / additional services charged or proposed to be charged by the other firms.

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

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

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

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

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

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

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

4.34R When the statutory auditor or the audit firm, or a member of its network, provides to the audited a public interest entity that it audits, its parent undertaking or its controlled undertakings, for a period of three or more
consecutive financial years, non-audit services other than those referred to in Article 5(1)\(^{43}\) of the EU Audit Regulation:

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

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

[AR 4.2]

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

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

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

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

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

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\(^{43}\) See paragraph 5.167R of Section 5 of Part B of this Ethical Standard.

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

\(^{45}\) The competent authority for this purpose is the Financial Reporting Council.
4.38 Where the firm and/or members of its network provide services to a group, the requirement in paragraph 4.37 shall apply on a group basis for all services provided by the firm and its network firms to all entities in the group and to their connected parties.

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

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

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

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

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

4.42 Where it is expected that the total fees for services receivable from a public interest entity or other listed entity and its subsidiaries relevant
to a recurring engagement by the firm  will regularly exceed 10% of the annual fee income of the firm or, where profits are not shared on a firm-wide basis, of the part of the firm by reference to which the engagement partner’s profit share is calculated, the firm shall not act as the provider of the engagement for that entity and shall either resign or not stand for reappointment, as appropriate.

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

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

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

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

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

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

47 In the case of a sole practitioner, annual fee income of the firm includes all earned income received by the individual.
discusses with both the threat to integrity, objectivity and independence of the firm and covered persons and whether safeguards need to be applied to eliminate or reduce the threat to a level where independence would not be compromised.

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

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

4.50 Such safeguards might include:

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

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

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

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

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

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

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

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

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

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

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

- is employed exclusively or principally on that engagement; and

- is remunerated on the basis of the performance of part of the firm which is substantially dependent on fees from that entity.

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

- reducing the dependence of the office, partner or other covered person by reallocating the work within the practice;

- a review by an engagement partner with relevant expertise who is not involved with the engagement to ensure that the integrity, objectivity or independence of the firm and covered persons is not affected by the self-interest threat.

Remuneration and Evaluation Policies

4.56D A firm shall have in place adequate remuneration policies, including profit-sharing policies, providing sufficient performance incentives to secure engagement quality. In particular, the amount of revenue that the
The firm shall establish policies and procedures to ensure that each of the following is true in relation to each entity relevant to an engagement by the firm:

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

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

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

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

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

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

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

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

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

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

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

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

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

Threatened and Actual Litigation

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

4.67 Where litigation (in relation to any services) actually takes place between the firm, its partners, or any covered person, and the entity or its affiliates, or where such litigation is considered probable, self-interest, advocacy and intimidation threats to the integrity, objectivity and independence of the firm and covered persons are created because the firm’s interest will be the achievement of an outcome to the dispute or litigation that is favourable to itself. In addition, an effective engagement process requires complete candour and full disclosure between the entity’s management and the engagement team: such disputes or litigation may place the two parties in opposing adversarial positions and may affect management’s willingness to make complete disclosure of relevant information. Where the firm can foresee
that such a threat may arise and independence compromised, the firm informs the audit committee of its intention to resign or, where there is no audit committee, the board of directors. Where applicable, the firm also informs any other persons or entities the firm is instructed to advise of its intention to withdraw from the engagement.

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

- the litigation was commenced as the engagement was about to be completed, and shareholder (or other stakeholder) interests would be adversely affected by a delay in the engagement;
- on appropriate legal advice, the firm deems that the threatened or actual litigation is vexatious or designed solely to bring pressure to bear on the opinion to be expressed by the firm.
### Section 5 – Non-audit / Additional Services

#### General Approach to Non-audit / Additional Services

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<th>Investment Circular Reporting Engagements</th>
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| **5.1**  
In relation to an investment circular reporting engagement, this Section applies only to those additional services provided by the firm to an entity relevant to the engagement during the ‘relevant period’. The relevant period covers the period during which the investment circular reporting engagement is undertaken and any additional period subsequent to the date of the most recent audited financial statements. Other services provided prior to that date are unlikely to create threats to integrity or objectivity because: |
| • where the reporting accountant undertook the last audit of the financial statements of an entity relevant to the engagement and complied with the FRC’s Ethical Standard, the requirements applicable to the provision of other services will have been observed; or |
| • where the last audit of the financial statements of an entity relevant to the engagement was undertaken by a different firm, the work done by the reporting accountant in providing other services will have been the subject of independent review in the course of the audit. |

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

| **5.3**  
ISAs (UK) require that auditors exercise professional judgment and maintain professional scepticism throughout the planning and performance of the audit and, among other things: |
| • Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity’s internal control. |
| • Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks. |
| • Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained\(^\text{48}\). |

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

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\(^{48}\) ISA (UK) 200 (Revised June 2016) ‘Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK)’ paragraph 7.
• Identifying, evaluating and testing, where appropriate, those internal control systems the effectiveness of which is necessary for the engagement and where, if any control weaknesses are identified, extended testing will be required; and

• additional work undertaken to respond to risks identified by management or the audit committee that the firm considers could impact the firm’s opinion on financial statements or on other subject matter information or subject matter of the engagement.

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

• The objective of that work is not to gather evidence to support the firm’s opinion on the financial statements or on other subject matter information or subject matter of the engagement; or

• The nature and extent of testing is not determined by the firm, or in the case of a group, the work of other firms in relation to group components, in the context of expressing an opinion on the financial statements or on other subject matter information or subject matter of the engagement; or

• The principal terms and conditions for the work differ from that of the engagement.

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

• is integrated with the work performed in the audit and performed largely by the existing audit team; and

• is performed on the same principal terms and conditions as the audit.

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

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

• does not relate to financial information and/or financial controls; or

• is not integrated with the work performed in the audit, or is not performed largely by the existing audit team, or

• is not on the same principal terms and conditions as the audit;

49 This does not include accounting services.
will be regarded as an ‘other non-audit service’ for the purpose of this Ethical Standard.

5.8 ‘Non-audit services’ comprise any engagement in which a firm, or a member of its network, provides professional services to:
- an audited entity;
- an audited entity’s affiliates; or
- another entity where the subject matter of the engagement includes the audited entity\textsuperscript{50} and/or its significant affiliates;

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

5.9 For a public interest assurance engagement other than an audit, ‘additional services’ comprise any engagement in which a firm, or a member of its network, provides professional services to an entity relevant to the engagement other than pursuant to:
(a) any other public interest assurance engagement;
(b) the audit of financial statements; and
(c) those other roles which legislation or regulation specify can be performed by the auditor of the entity (for example, considering the preliminary announcements of listed companies, complying with the procedural and reporting requirements of regulators, such as requirements relating to the audit of the client’s internal controls and reports in accordance with Section 714 of the Companies Act 2006).

Where the entity relevant to the engagement is a member of a group, additional services for the purposes of this Ethical Standard include:
- services provided by the firm to the parent entity or to any of its significant affiliates; and
- services provided by a network firm which is involved in the engagement to the entity relevant to the engagement or any of its significant affiliates.

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

\textsuperscript{50} For example, where an engagement is undertaken to assist in the preparation of listing particulars for a company acquiring the audited entity

\textsuperscript{51} For example, in a vendor due diligence engagement, the engagement is initiated and scoped by the vendor before the purchaser is identified. If an entity audited by the firm undertaking the due diligence engagement is the purchaser, that audited entity may gain the benefit of the report issued by its auditor, it may be a party to the engagement letter and it may pay an element of the fee.
relevant to an engagement, are identified, and whether any safeguards need to be put in place. For example, when the results of such a non-audit / additional service performed by the firm are reflected in the financial statements or other subject matter information or subject matter of an engagement; or where the fees earned from such a non-audit / additional service performed by the firm could be perceived as compromising independence for an engagement by the firm.

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

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

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

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

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

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

52 The UK Corporate Governance Code requires audit committees to develop the company’s policy on the engagement of the external auditor to supply non-audit services.
(ii) reference to records of past and current additional services provided by the firm;

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

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

Identification and Assessment of Threats and Safeguards

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

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

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

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

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

- The likely relevance and impact of the non-audit/additional service on the financial statements, or on subject matter information or subject matter of the engagement;
- The extent to which performance of the proposed non-audit/additional service will involve the exercise of professional judgment;
- The size of the non-audit/additional service and the associated fee;
- The basis on which the fee is to be calculated;
- The staff who would be carrying out the non-audit/additional service53;
- The staff from the entity relevant to the engagement who would be involved in the non-audit/additional service54.

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

54 For example, the safeguards necessary to address any self-review threat will require careful consideration where those involved are particularly senior and can be expected to be actively involved in any audit discussion as this may also create an intimidation threat.
To ensure that this assessment is made with a proper understanding of the nature of the non-audit / additional service, it may be necessary to refer to a draft engagement letter in respect of the proposed non-audit / additional service or to discuss the service with the partner involved.

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

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

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

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

(a) not undertake the non-audit / additional service; or
(b) not accept or shall withdraw from the engagement as appropriate.

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

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

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55 This includes consideration of any private reporting engagements associated with the transaction which is the subject of the investment circular that were undertaken before the investment circular was contemplated.
Similarly, in relation to a possible appointment as provider of an audit engagement or other public interest assurance engagement to an entity that the firm has not provided such an engagement before, consideration needs to be given to recent, current and potential non-audit / additional services provided by the firm to the entity. The firm does not accept appointment to undertake such an engagement unless it is probable that an objective, reasonable and informed third party, taking into account safeguards applied, would conclude that the independence of the firm or covered persons are not compromised.

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

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

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

Threats to Objectivity and Independence

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

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

**Safeguards**

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

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

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

- if circumstances require, to address the threat identified, there is effective physical and electronic segregation of the individuals in each team, and of their documentation, at all times during the provision of the engagement and non-audit / additional services; and/or

- the team providing the non-audit / additional services avoids taking any action or making any statement that compromises the integrity or objectivity and independence of the engagement team, for example, expressing any opinion about the approach that the engagement team might take or the conclusion it might reach when considering the appropriateness of accounting or other judgments.

The Ethics Partner establishes policies and procedures to ensure that, where safeguards of this nature are considered appropriate, the arrangements put in place are effective at all times. This will involve the Ethics Partner/Function being satisfied that there are effective arrangements in place for each member of the non-audit / additional services team to acknowledge their responsibilities and for each member of the engagement team to notify him or her of any breach of this requirement that the team member becomes aware of. Where notified of a breach, the Ethics Partner/Function considers together with the engagement partner the significance of the breach and the implications for the integrity, objectivity and independence of the engagement team, including whether any further safeguards are necessary and whether the matter should be reported to those charged with governance of the entity;
(b) The engagement quality control reviewer, or another partner of sufficient relevant experience and seniority who is, and is seen to be, an effective challenge to both the engagement partner and the partner leading the non-audit / additional services, reviews the work and conclusions of the engagement team. The review includes consideration of the judgments of the persons conducting the engagement, if any, relating to the subject matter of the non-audit / additional service, having regard to the self-review threat identified, and determines and documents his or her conclusions as to whether the work is sufficient and the conclusions of the engagement team are appropriate. Where the review partner has concerns, the engagement partner does not sign the engagement opinion/report until those concerns have been subject to full consultation, including escalation through any processes required by the firm’s policies. Where this safeguard is considered appropriate, the Ethics Partner/Function is satisfied that the review partner undertaking this role is appropriate, that the review partner is aware of the circumstances leading to the conclusion that there is a significant self-review threat and that any concerns raised by the review partner have been satisfactorily resolved before signature of the opinion.

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

(a) not undertake the non-audit / additional service; or
(b) not accept or shall withdraw from the engagement as appropriate.

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

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

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

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

Communication with Those Charged With Governance

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

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

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

Documentation

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

5.37 Matters to be documented include any significant judgments concerning:

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

5.38 In situations where a management threat is identified in connection with the provision of non-audit / additional services, this documentation will include the assessment of the persons conducting the engagement of whether there is
informed management. The documentation of communications with the entity where judgments and decisions are made by management may take a variety of forms, for example an informal meeting note covering the matters discussed.

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

Audit Related Services

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

5.41 Audit related services are:

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

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

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

56 This does not include accounting services.
Evaluation of Specific Non-audit Services and Additional Services

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

- Reports, that are not ‘audit related services’, required by the competent authorities / regulators supervising the audited entity, where the authority / regulator has either specified the auditor to provide the service or identified to the entity that the auditor would be an appropriate choice for service provider. These might include, for example:
  - in relation to entities regulated under the Financial Services and Markets Act 2000 (FSMA), reports under s166 and s340 of FSMA; and
  - other reports provided for under the rules of a competent authority / regulator.

- Audit and other services provided as auditor of the entity, or as reporting accountant, in relation to information of the audited entity for which it is probable that an objective, reasonable and informed third party would conclude that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service, and where the nature of the service would not compromise independence. These might include, for example:
  - audit and other services relating to public reporting as reporting accountant on financial or other information of the audited entity in a prospectus or circular (including reports that may be required by the Prospectus Rules, the Listing Rules and the Take Over Code);
  - services, including private reporting, that are customarily performed by the reporting accountant to support statements made by the directors, disclosures in a prospectus or circular or, in the case of premium listed issuers, to support confirmations provided by the sponsor to the FCA;
  - audit and other assurance services relating to public reporting on other information issued by the entity, such as reports on information in the front of annual reports not covered by the auditor’s report on the financial statements.

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

5.45 In evaluating threats to compliance with the overarching principles of integrity, objectivity and independence arising from the provision of non-audit / additional services, the requirements and guidance below apply to all entities as indicated relevant to an engagement. This includes for public interest entities and their significant affiliates where applicable. Where a more stringent requirement for an audited public interest entity is established in
paragraph 5.167R below, that more stringent requirement must be complied with.

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

5.47 For the purpose of the requirements below, an ‘SME listed entity’ is:

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

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

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

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

• an average number of employee during the financial year of less than 250;

• a total balance sheet not exceeding €43m;

• an annual net turnover not exceeding €50m.

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

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

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

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

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

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

All such services would fall within the term ‘internal audit services’.

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

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

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

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

- internal audit projects undertaken by the firm are performed by partners and staff who have no involvement in the engagement;
- the engagement is reviewed by partner with relevant expertise who is not involved in the engagement, to ensure that the internal audit work performed by the firm has been properly and effectively assessed in the context of the engagement.
5.53 The firm shall not provide internal audit services to an entity relevant to an engagement where it is reasonably foreseeable that:

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

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

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

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

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

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

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

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

• Taking decisions on the scope and nature of the internal audit services to be provided to the entity;
• Designing internal controls or implementing changes thereto;
• Taking responsibility for risk management decisions;
• Undertaking work to evaluate the cost effectiveness of activities, systems and controls;
• Undertaking pre-implementation work on non-financial systems.

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

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

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

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

5.59 Additional work will not be considered an ‘audit related service’ if it:
• does not relate to financial information and/or financial controls; or
• is not authorised by those charged with governance; or
• is not integrated with the work performed in the audit, or is not performed largely by the existing audit team; or
• is not on the same principal terms and conditions as the audit.

In such circumstances the threats and the safeguards will be communicated to those charged with governance. The engagement partner reviews the scope and objectives of the proposed work and assesses the threats to which it gives rise and the safeguards available. Whether it is appropriate for this
work to be undertaken by the audit firm will depend on the extent to which it gives rise to threats to the auditor’s integrity, objectivity or independence.

**Information Technology Services**

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

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

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

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

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

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

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

(c) where the firm is undertaking an investment circular reporting engagement, for the purposes of the information technology services, the firm would undertake part of the role of management in relation to the transaction or the financial information that is the subject of the investment circular reporting engagement.
For audits of public interest entities the prohibition established in paragraph 5.167R(e) must also be complied with.

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

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

Valuation Services

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

5.67 The firm shall not provide a valuation service to:

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

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

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

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

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

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

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

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

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

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

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

Actuarial Valuation Services

5.74 The firm shall not provide actuarial valuation services to:

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

(b) any other entity relevant to an engagement, unless the firm is satisfied that either all significant judgments, including the assumptions, are made by informed management or the valuation
has no material effect on the financial statements, or other subject matter information or subject matter of the engagement, either separately or in aggregate with other valuations provided.

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

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

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

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

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

Tax Services

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

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

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

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

Whilst it is possible to consider tax services under broad headings, such as tax planning or compliance, in practice these services are often interrelated and it is impracticable to analyse services in this way for the purposes of
attempting to identify generically the threats to which specific tax services give rise. As a result, firms need to identify and assess, on a case-by-case basis, the potential threats to the integrity, objectivity and independence of the firm and covered persons before deciding whether to provide tax services to an entity relevant to an engagement.

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

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

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

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

5.83 The firm shall not promote tax structures or products or provide tax advice to an entity relevant to an engagement where the engagement partner has, or ought to have, reasonable doubt as to whether the related accounting treatment involved is based on well-established interpretations or is appropriate, having regard to the relevant financial reporting framework, including, where applicable, the requirement for financial statements to give a true and fair view.

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

5.84 Where the firm promotes tax structures or products or provides tax advice to an entity relevant to an engagement, it may be necessary to adopt an accounting treatment that is not based on well-established interpretations or
may not be appropriate, in order to achieve the desired result. A self-review threat arises in the course of an engagement because the firm may be unable to form an impartial view of the accounting treatment to be adopted for the purposes of the proposed arrangements. Accordingly, this Ethical Standard does not permit the promotion of tax structures or products by firms to an entity relevant to an engagement where, in the view of the engagement partner, after such consultation as is appropriate, there is reasonable doubt as to whether the effectiveness of the tax structure or product depends on an accounting treatment that is well-established and appropriate.

5.85 The firm shall not provide tax services wholly or partly on a contingent fee basis to:

(a) a listed entity relevant to an engagement that is not an SME listed entity (see paragraph 5.47), or a significant affiliate of such an entity; or

(b) or any other entity relevant to an engagement, where not otherwise prohibited by paragraph 4.14 of Section 4 of Part B of this Ethical Standard, for which the tax outcome in respect of the services (and, therefore, the amount of the fee) is uncertain, dependent on the proposed application of tax law, and may be material to present or future financial statements or other subject matter information or subject matter of the engagement.

For audits of public interest entities the prohibitions established in paragraph 5.167R(a) must also be complied with, subject to the derogations provided for in paragraph 5.168R.

5.86 Paragraph 4.14 of Section 4 of Part B of this Ethical Standard establishes conditions that preclude providing non-audit / additional services on a contingent fee basis.

5.87 Where tax services, such as advising on corporate structures, structuring transactions to achieve a particular effect, or otherwise with an objective of reducing tax charges are undertaken on a contingent fee basis for an entity relevant to an engagement, self-interest threats to the integrity, objectivity and independence of the firm or covered persons may arise. The firm may have, or may appear to have, an interest in the success of the tax services, causing the firm to make a judgment about which there is reasonable doubt as to its appropriateness. For an entity relevant to an engagement that is a listed entity that is not an SME listed entity, or a significant affiliate of such an entity, the self-interest threat cannot be eliminated or reduced to a level where independence is not compromised by the application of any safeguards.

5.88 For other entities relevant to an engagement, the self-interest threat cannot be eliminated or reduced to a level where independence is not compromised by the application of any safeguards where the outcome in respect of the services (and, therefore, the amount of the contingent fee) is uncertain, dependent on the proposed application of tax law, and where the tax implications are, or may be, material to present or future financial statements or other subject matter information or subject matter of the engagement.

5.89 The firm shall not provide tax services to an entity relevant to an engagement other than an investment circular reporting engagement.
where the service would involve the firm undertaking a management role.

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

5.90 The firm shall not provide tax services to an entity relevant to an investment circular reporting engagement where the service would involve the firm undertaking a management role in relation to the transaction or the financial information that is the subject of the investment circular reporting engagement.

5.91 When providing tax services to an entity relevant to an engagement, there is a risk that the firm undertakes a management role, unless the firm is working with 'informed management'.

5.92 Where an entity relevant to the engagement is a listed entity that is not an SME listed entity (see paragraph 5.47), or a significant affiliate of such an entity, the firm shall not provide a service to prepare current or deferred tax calculations that are or may reasonably be expected to be used by the entity when preparing accounting entries that are material to the financial statements or other subject matter information or subject matter of the engagement.

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

5.93 For listed entities that are not SME listed entities, or significant affiliates of such entities, the threats to integrity, objectivity and independence that would be created are too high to allow the firm to provide a service to prepare calculations of current or deferred tax liabilities or assets for the purpose of preparing accounting entries that are material to the financial statements or other subject matter information or subject matter of the engagement, together with associated disclosure notes.

5.94 Paragraph 5.92 is not intended to prevent a firm preparing tax calculations after the completion of the engagement for the purpose of submitting tax returns.

5.95 For entities other than public interest entities and other listed entities that are not SME listed entities, or significant affiliates of listed entities that are not SME listed entities, the firm may provide a service to prepare current or deferred tax calculations for the purpose of preparing accounting entries, provided that:

(a) such services:

(i) do not involve initiating transactions or taking management decisions; and

(ii) are of a technical, mechanical or an informative nature; and

(b) appropriate safeguards are applied.
5.96 The firm’s policies and procedures will set out whether there are circumstances in which current or deferred tax calculations for the purpose of preparing accounting entries are not prepared for non-listed entities as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

5.97 The firm shall not provide tax services to an entity relevant to an engagement where this would involve acting as an advocate for the entity in the resolution of an issue:

(a) that is material to the entity’s present or future financial statements, or the subject matter information or subject matter of the engagement; or

(b) where the outcome of the tax issue is dependent on a future or contemporary judgment by the firm in relation to the financial statements, or other subject matter information or subject matter of the engagement.

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

5.98 Supporting ethical provision 2.3D, which embodies legal requirements for statutory audits, requires, inter alia, that a firm does not accept, continue or carry out an engagement if there is any threat of advocacy which would compromise the independence of the firm or covered persons. Where the tax services to be provided by the firm include representing the entity in any negotiations or proceedings involving the tax authorities, advocacy threats to the integrity, objectivity and independence of the firm and covered persons may arise.

5.99 The meaning of an ‘advocacy threat’ is described in paragraph 1.29 of Section 1 of Part B of this Ethical Standard. It includes supporting a position taken by management in an adversarial context, where the firm has to adopt a position closely aligned to that of management.

5.100 The firm is not acting as an advocate where the tax services involve the provision of information to the tax authorities (including an explanation of the approach being taken and the arguments being advanced by the entity). In such circumstances effective safeguards may exist and the tax authorities will undertake their own review of the issues.

5.101 Where the firm has been providing assistance in dealing with tax authorities and those tax authorities indicate that they are minded to reject the entity’s arguments on a particular issue and the matter is likely to be determined by an appeals tribunal or court, the firm may become so closely identified with management’s arguments that the firm is inhibited from forming an impartial view of the treatment of the issue in the financial statements, or in other subject matter information or subject matter of the engagement in the case of an other public interest assurance engagement. In such circumstances, if the issue is material to the financial statements, or other subject matter information or subject matter of the engagement, or is dependent on a future or contemporary judgment by the firm in relation to the engagement, the advocacy threat will be such that no safeguards can reduce it to a level where independence is not compromised. Accordingly, in such circumstances, the
firm discusses the matter with the entity and makes it clear that it will have to withdraw from providing tax services that require it to act as advocate for the entity, or resign from the engagement from the time when the matter is formally listed for hearing before the appeals tribunal.

5.102 If the firm withdraws from providing tax services for the reasons described in paragraph 5.101, the firm is not precluded from having a continuing role (for example, responding to specific requests for information) for the entity in relation to the appeal, providing that the continuing role does not give rise to an advocacy threat that would compromise the independence of the firm or covered persons. The firm also assesses the threat associated with any continuing role in accordance with paragraphs 5.103 to 5.105 of this Section.

Litigation Support Services

5.103 Although management and advocacy threats may arise in litigation support services, such as acting as an expert witness, the primary issue is that a self-review threat will arise in all cases where such services involve a subjective estimation of the likely outcome of a matter that is material to the amounts to be included or the disclosures to be made in the financial statements.

5.104 The firm shall not provide litigation support services to:

(a) a listed entity relevant to an engagement that is not an SME listed entity (see paragraph 5.47), or a significant affiliate of such an entity, where this would involve the estimation by the firm of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the listed entity’s financial statements, or in other subject matter information or subject matter of the engagement, either separately or in aggregate with other estimates and valuations provided; or

(b) any other entity relevant to an engagement, where this would involve the estimation by the firm of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the entity’s financial statements, or in other subject matter information or subject matter of the engagement, either separately or in aggregate with other estimates and valuations provided and there is a significant degree of subjectivity involved.

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

5.105 In the case of non-listed entities, litigation support services that do not involve such subjective estimations are not prohibited, provided that the firm has carefully considered the implications of any threats and established safeguards to reduce those threats to a level where independence is not compromised.

5.106 The firm’s policies and procedures will set out whether there are circumstances in which litigation support services are not undertaken for non-listed entities as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.
Legal Services

5.107 The firm shall not provide legal services to an entity relevant to an engagement, where this would involve acting as the solicitor formally nominated to represent the entity in the resolution of a dispute or litigation which is material to the amounts to be included or the disclosures to be made in the financial statements, or in other subject matter information or subject matter of the engagement.

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

5.108 Although the provision by the firm of certain types of legal services to an entity relevant to an engagement may create advocacy, self-review and management threats, this Ethical Standard does not impose a general prohibition on the provision of legal services. However, in view of the degree of advocacy involved in litigation or other types of dispute resolution procedures and the potential importance of any assessment by the firm of the merits of the entity's position when undertaking an engagement, this Ethical Standard prohibits a firm from acting as the formally nominated representative for an entity relevant to an engagement in the resolution of a dispute or litigation which is material to the amounts recognised or disclosed the financial statements or other subject matter information or subject matter of the engagement.

Recruitment and Remuneration Services

5.109 The firm shall not provide recruitment services to an entity relevant to an engagement, that would involve the firm taking responsibility for the appointment of any director or:

(a) where the firm is undertaking an engagement other than an investment circular reporting engagement, any employee of the entity; or

(b) where the firm is undertaking an investment circular reporting engagement, any employee of the entity who will be involved in an area that is directly concerned with the transaction which is the subject of the investment circular.

For audits of public interest entities the prohibitions established in paragraphs 5.167R(b) and(k) must also be complied with.

5.110 A management threat arises where firm personnel take responsibility for any decision as to who is appointed by the entity.

5.111 For a listed entity, that is not an SME listed entity (see paragraph 5.47), relevant to an engagement, the firm shall not provide recruitment services in relation to a key management position of the entity, or a significant affiliate of such an entity.

For audits of public interest entities the prohibition established in paragraph 5.167R(k) must also be complied with.
5.112 A familiarity threat arises if the firm plays a significant role in relation to the identification and recruitment of senior members of management within the entity, as the engagement team may be less likely to be critical of the information or explanations provided by such individuals than might otherwise be the case. Accordingly, for a listed entity relevant to an engagement, other than an investment circular reporting engagement, that is not an SME listed entity, and for significant affiliates of such entities, the firm does not provide services that involve the recruitment of individuals for key management positions.

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

5.114 Where the firm providing an investment circular reporting engagement has played a significant role in relation to the identification and recruitment of a senior member of management within the entity, including all directors, prior to the ‘relevant period’, the engagement partner considers whether a familiarity threat exists, taking account of factors such as:

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

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

5.115 Recruitment services involve a specifically identifiable, and separately remunerated, engagement. Firms and engagement teams may contribute to an entity’s recruitment process in less formal ways. The prohibitions set out in paragraphs 5.109 and 5.111 do not extend to:

- senior members of an engagement team interviewing prospective directors or employees of the entity and advising on the candidate’s technical financial competence; or
- the entity using information gathered by the firm, including that relating to salary surveys.

5.116 The firm shall not provide advice on the quantum of the remuneration package or the measurement criteria on which the quantum is calculated, for a director or key management position of an entity relevant to an engagement.

For audits of public interest entities the prohibition established in paragraph 5.167R(k) must also be complied with.
The provision of advice on remuneration packages (including bonus arrangements, incentive plans and other benefits) to existing or prospective employees of the entity gives rise to familiarity threats. The significance of the familiarity threat is considered too high to allow advice on the overall amounts to be paid or on the quantitative measurement criteria included in remuneration packages for directors and key management positions.

For other employees, these threats can be adequately addressed by the application of safeguards, such as the advice being provided by partners and staff who have no involvement in the engagement.

In cases where all significant judgments concerning the assumptions, methodology and data for the calculation of remuneration packages for directors and key management are made by 'informed management' or a third party and the firm's role is limited to applying proven methodologies using the given data, for which the management takes responsibility, it may be possible to establish effective safeguards to protect the integrity, objectivity and independence of the firm and covered persons.

Advice on tax, pensions and interpretation of accounting standards relating to remuneration packages for directors and key management can be provided by the firm, provided they are not prohibited by the requirements of this Ethical Standard relating to tax, actuarial valuations and accounting services. Disclosure of the provision of any such advice would be made to those charged with governance of the entity (see Section 1 of this Ethical Standard, paragraphs 1.61 to 1.71 of Section 1 of part B of this Ethical Standard).

Corporate Finance Services

The range of services encompassed by the term ‘corporate finance services’ is wide. For example, the firm may undertake:

- to identify possible purchasers for parts of the entity’s business and provide advisory services in the course of such sales; or
- to identify possible ‘targets’ for the entity to acquire; or
- to advise the entity on how to fund its financing requirements; or
- to act as sponsor on admission to listing on the London Stock Exchange, or as Nominated Advisor on the admission of the entity on the Alternative Investments Market (AIM); or
- to act as financial adviser to entity offerors or offerees in connection with public takeovers.

The potential for the integrity, objectivity and independence of the firm and covered persons to be compromised through the provision of corporate finance services varies considerably depending on the precise nature of the service provided. The main threats to integrity, objectivity and independence arising from the provision of corporate finance services are the self-review, management and advocacy threats. Self-interest threats may also arise, especially in situations where the firm is paid on a contingent fee basis.

When providing corporate finance services to an entity relevant to an engagement, there is a risk that the firm undertakes a management role,
unless the firm is working with ‘informed management’. In addition, appropriate safeguards are applied to reduce any self-review threat to a level where independence is not compromised.

5.124 Examples of safeguards that may be appropriate when corporate finance services are provided to an entity relevant to an engagement, include ensuring that:

- the corporate finance advice is provided by partners and staff who have no involvement in the engagement;
- any advice provided is reviewed by an independent corporate finance partner within the firm;
- external independent advice on the corporate finance work is obtained;
- a partner who is not involved in the engagement reviews the engagement work performed in relation to the subject matter of the corporate finance services provided to ensure that such engagement work has been properly and effectively reviewed and assessed in the context of the engagement.

5.125 Where the firm provides corporate finance services to an entity relevant to an engagement in connection with conducting the sale or purchase of a material part of the entity’s business, the engagement partner informs the audit committee (or equivalent) and, where applicable, any other person or entity the firm is instructed to advise, about the corporate finance service, as set out in paragraphs 1.61 to 1.71 of Section 1 of Part B of this Ethical Standard.

5.126 The firm shall not provide corporate finance services in respect of an entity relevant to an engagement, where:

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

(b) the engagement partner has, or ought to have, reasonable doubt as to whether an accounting treatment that is subject to a contemporary or future judgment by the firm relating to a material matter in the financial statements or in other subject matter information or subject matter of the engagement, and upon which the success of the related transaction depends:
   (i) is based on well-established interpretations; or
   (ii) is appropriate;

having regard to the requirements of the relevant reporting framework, including where applicable for financial statements to give a true and fair view; or

(c) the firm is undertaking an engagement other than an investment circular reporting engagement, and the service would involve undertaking a management role in the entity; or

(d) the firm is undertaking an investment circular reporting engagement, and the service would involve undertaking a management role in the entity in relation to the transaction or the subject matter information or subject matter of the investment circular reporting engagement.
For audits of public interest entities the prohibitions established in paragraphs 5.167R(b), (i) and (j) must also be complied with.

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

5.128 Where the firm acts as a sponsor under the Listing Rules57, or as Nominated Adviser on the admission of the entity to AIM, the firm is required to confirm that the entity has satisfied all applicable conditions for listing and other relevant requirements of the listing (or AIM) rules. Where there is, or there ought to be, reasonable doubt that the firm will be able to give that confirmation, it does not enter into providing such service.

5.129 A self-review threat arises where the outcome or consequences of the corporate finance service provided by the firm may be material to the financial statements or other subject matter information or subject matter, which are, or will be, subject to an engagement by the same firm. Where the firm provides corporate finance services, for example advice to the entity on financing arrangements, it may be necessary to adopt an accounting treatment that is not based on well-established interpretations or which may not be appropriate, in order to achieve the desired result. A self-review threat is created because the firm may be unable to form an impartial view of the accounting treatment to be adopted for the purposes of the proposed arrangements. Accordingly, this Ethical Standard does not permit the provision of such services by firms in respect of an entity relevant to an engagement by them where there is or ought to be reasonable doubt as to whether an accounting treatment that is subject to a contemporary or future judgment by the firm relating to a material matter in the financial statements, or in other subject matter information or subject matter, of the entity and on which the success of a transaction depends is well-established and appropriate.

5.130 Advice to entities on funding issues and banking arrangements, where there is no reasonable doubt as to the appropriateness of the accounting treatment, is not prohibited provided this does not involve the firm in taking decisions or making judgments which are properly the responsibility of management.

5.131 These restrictions do not apply in circumstances where the firm is designated by legislation or regulation as being required to carry out a particular service. In such circumstances, the engagement partner establishes appropriate safeguards.

Transaction Related Services

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

- investigations into possible acquisitions or disposals (‘due diligence’ investigations); or

57 The UK Listing Authority’s publication the ‘Listing Rules’.
• investigations into the tax affairs of possible acquisitions or disposals; or
• the provision of information to management or sponsors in relation to prospectuses and other investment circulars (for example, long form reports, comfort letters on the adequacy of working capital); or
• agreed-upon procedures or reports provided to management in relation to particular transactions (for example, securitisations).

5.133 When providing transaction related services to an entity relevant to an engagement, there is a risk that the firm may face a management threat, unless the firm is working with informed management. In addition, appropriate safeguards are applied to reduce any self-review threat to a level where independence is not compromised.

5.134 Examples of safeguards that may be appropriate when threats are identified in relation to transaction related services provided to an entity relevant to an engagement include ensuring that:
• the transaction related advice is provided by partners and staff who have no involvement in the engagement;
• any advice provided is reviewed by an independent transactions partner within the firm;
• external independent advice on the transaction related work is obtained;
• a partner with relevant expertise who is not involved in the engagement reviews the engagement work performed in relation to the subject matter of the transaction related service provided to ensure that such work has been properly and effectively reviewed and assessed in the context of the engagement.

5.135 The firm shall not provide transaction related services in respect of an entity relevant to an engagement, where:

(a) the engagement partner has, or ought to have, reasonable doubt as to whether an accounting treatment that is subject to a contemporary or future judgment by the firm relating to a material matter in the financial statements, or other subject matter information or subject matter of the engagement, and upon which the success of the related transaction depends;
   (i) is based on well-established interpretations; or
   (ii) is appropriate;
   having regard to the requirements of the relevant reporting framework, including where applicable for financial statements to give a true and fair view; or
(b) the firm is undertaking an engagement other than an investment circular reporting engagement, and the service would involve undertaking a management role in the entity; or
(c) the firm is undertaking an investment circular reporting engagement, and the service would involve undertaking a management role in the entity in relation to the transaction or the subject matter information or subject matter of the investment circular reporting engagement.
For audits of *public interest entities* the prohibition established in paragraphs 5.167R(b) and (i) must also be complied with.

5.136 A self-review threat arises where the outcome of the transaction related services undertaken by the *firm* may be material to the financial statements or other *subject matter information* or *subject matter* of the entity which are, or will be, subject to an *engagement* by the same *firm*. Where the entity proposes to undertake a transaction, it may be necessary to adopt an accounting treatment that is not based on well-established interpretations or may not be appropriate, in order to achieve the desired result of the transaction (for example, to take assets off the balance sheet). A self-review threat is created if the *firm* undertakes transaction related services in connection with such a transaction. Accordingly, this Ethical Standard does not permit the provision of services by *firms* in respect of an *entity relevant to an engagement* by them where there is or ought to be reasonable doubt as to whether an accounting treatment, that is subject to a contemporary or future judgment by the *firm* relating to a material matter in the financial statements, or in other *subject matter information* or *subject matter* of the entity and on which the success of a related transaction depends, is well-established and appropriate.

5.137 These restrictions do not apply in circumstances where the *firm* is designated by legislation or regulation as being required to carry out a particular service. In such circumstances, the *engagement partner* establishes appropriate safeguards.

**Restructuring Services**

5.138 Restructuring services are any *non-audit services* provided to an entity in connection with the entity’s development or implementation of a transaction or package of transactions (a ‘restructuring plan’) designed to change its equity or debt financing structure, its corporate structure, or its operating structure. There are a variety of possible purposes for developing a restructuring plan, for example to address financial or operating difficulties, to support tax planning, to improve operating efficiency, or to improve the cost of capital. The range of *non-audit / additional services* that may be regarded as ‘Restructuring Services’ is extensive, and the nature of those services may encompass many of the other types of *non-audit / additional services* discussed in this Ethical Standard. Where applicable, the related requirements and guidance covered elsewhere in this Ethical Standard apply to Restructuring Services.

5.139 The restructuring services that an entity may use a *firm* to provide may vary considerably and may range from the incidental and routine to advice that is fundamental to the efficacy of the restructuring plan. Consequently, where such services are provided by a *firm* that provides an *engagement* for the entity, the *engagement partner*:

- the threats that the restructuring services may present to the *firm’s* ability to conduct any contemporary or future *engagement* with integrity, objectivity and independence; and
- the probability that an objective, reasonable and informed third party would conclude that the independence of the *firm* or *covered persons*
would be compromised.

5.140 The firm shall not provide restructuring services in respect of an entity relevant to an engagement, where:

(a) the service would involve the firm undertaking a management role in or on behalf of the entity; or

(b) the service would require the firm to act as an advocate for the entity in relation to matters that are material to the financial statements, or other subject matter information or subject matter of the engagement.

For audits of public interest entities the prohibition established in paragraphs 5.167R(b) and (i) must also be complied with.

5.141 The potential for the integrity, objectivity and independence of the firm or covered persons to be compromised through the provision of restructuring services varies depending on the nature of the service provided. Two of the main threats to integrity, objectivity and independence arising from the provision of restructuring services arise where the firm undertakes a management or advocacy role:

- A firm undertakes a management role if the entity does not have ‘informed management’ capable of taking responsibility for the decisions to be made.

- To avoid undertaking an advocacy role on behalf of the entity, the firm takes particular care not to assume (or seen to be assuming) responsibility for the entity’s proposals or being regarded as negotiating on behalf of the entity or advocating the appropriateness of the proposals such that its independence would be compromised. This is particularly important when the firm attends meetings with the entity’s bank or other interested parties.

If the firm undertakes a management role or acts as advocate for the entity, the threats to integrity, objectivity and independence of the firm and covered persons are such that no safeguards can reduce the threat to a level where independence is not compromised\(^{58}\).

5.142 The firm shall not provide restructuring services in respect of an entity relevant to engagement, where that service may give rise to a self-review threat in the course of a contemporary or future engagement unless it is satisfied that such threats can be reduced by appropriate safeguards to a level where independence is not compromised and that such safeguards have been put in place.

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

5.143 The provision of restructuring services gives rise to a self-review threat where the restructuring services to be provided involve advice or judgments which

\(^{58}\) ‘ES – Provisions Available for Small Entities (Revised)’ provides exemptions relating to informed management and the advocacy threat for auditors of small entities.
are likely to be material to a contemporary or future judgment of the firm in relation to an engagement.

5.144 Examples of restructuring services that the firm may be requested to undertake and which may give rise to a self-review threat include:

- Providing preliminary general advice on the options and choices available to management or stakeholders of an entity facing urgent financial or other difficulties.
- Undertaking a review of the business of the entity with a view to advising the entity on liquidity management or operational restructuring options.
- Advising on the development of forecasts or projections, for presentation to lenders and other stakeholders, including assumptions.
- Advising the entity on how to fund its financing requirements, including equity and debt restructuring programmes.
- Participating in the design or implementation of an overall restructuring plan including, for example, participating in the preparation of cash flow and other forecasts and financial models underpinning the overall restructuring plan.

5.145 The self-review threat arising from the provision of such services is particularly significant where, in relation to an audit engagement, it has potential to impact the firm's assessment of whether it is appropriate to prepare the entity's financial statements on a going concern basis. Where the firm has been involved in aspects of the preparation of a cash flow, a forecast or a financial model, it is probable that an objective, reasonable and informed third party would conclude that the firm would have a significant self-review threat in considering the going concern assumption.

5.146 The self-review threat arising from the provision of such services is also particularly significant where the restructuring services are provided in respect of an audited entity and involve developing or implementing a restructuring plan to address the actual or anticipated financial or operational difficulties that threaten the survival of that entity as a going concern (an 'audited entity in distress').

5.147 The firm puts in place those safeguards that it regards as appropriate to reduce the threats to the integrity and objectivity of the firm and covered persons to a level where independence is not compromised. If the firm concludes that the threats arising from some or all of the restructuring services involved cannot be addressed by putting appropriate safeguards in place, it declines providing the service, or those parts of the service affected by those threats that cannot be adequately addressed.

5.148 Where an entity in distress relevant to an engagement, is a listed entity that is not an SME listed entity (see paragraph 5.47), or a significant affiliate of such a listed entity, the restructuring services provided by the firm shall be limited to providing:

(a) preliminary general advice to an entity in distress;

(b) assistance with the implementation of elements of an overall restructuring plan, such as the sale of a non-significant
component business, provided those elements are not material to the overall restructuring plan;

(c) challenging, but in no circumstances developing, the projections and assumptions within a financial model that has been produced by the entity in distress;

(d) reporting on a restructuring plan, or aspects of it, in connection with the proposed issue of an investment circular; and

(e) where specifically permitted by a regulatory body with oversight of the entity in distress.

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

5.149 Except to the extent identified in paragraph 5.148, the significance of the self-review threat is too high to permit the provision of other restructuring services to an entity in distress that is a listed entity that is not an SME listed entity, or a significant affiliate of such a listed entity, because there are no safeguards that would be sufficient to reduce the resultant threats to a level where independence is not compromised.

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

Accounting Services

5.151 For the purpose of this Ethical Standard, the term 'accounting services' is defined as the provision of services that involve the maintenance of accounting records or the preparation of financial statements or other subject matter information or subject matter that are then subject to audit or an other public interest assurance engagement. Advice on the implementation of current and proposed accounting standards is not included in the term accounting services.

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

- the firm may take over the provision of a specific accounting function on an outsourced basis (for example, payroll);

- the entity maintains the accounting records, undertakes basic bookkeeping and prepares a year-end trial balance and asks the firm to assist with the preparation of the necessary adjustments and the financial statements.

5.153 The provision of accounting services by the firm to an entity relevant to an engagement creates threats to the integrity, objectivity and independence of the firm and covered persons, principally self-review and management threats, the significance of which depends on the nature and extent of the accounting services in question and upon the level of public interest in the entity.
5.154 When providing accounting services to an entity relevant to an audit or other public interest assurance engagement by the firm, unless the firm is working with informed management, there is a risk that the firm undertakes a management role.

5.155 The firm shall not provide accounting services to an entity relevant to an engagement other than an investment circular reporting engagement where:

(a) the entity is a listed entity that is not an SME listed entity (see paragraph 5.47), relevant to an engagement by the firm, or a significant affiliate of such an entity; or

(b) for any other entity:

- those accounting services would involve the firm undertaking part of the role of management; or
- the financial information is the subject of an investment circular reporting engagement.

For audits of public interest entities the prohibitions established in paragraphs 5.167R(a)(i)-(a)(iii), (b), (c) and (d) must also be complied with, subject to the derogation provided for in paragraph 5.168R regarding 5.167R(a)(i).

5.156 The firm shall not provide accounting services in relation to the financial information that is the subject of an investment circular reporting engagement by the firm.

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

- comments on weaknesses in the accounting records and suggestions for addressing them;
- errors identified in the accounting records and in the financial statements, or other subject matter information or subject matter, and suggestions for correcting them;
- advice on the accounting policies in use and on the application of current and proposed accounting standards.

This advice is a by-product of the engagement rather than the result of any undertaking to provide non-audit/additional services. Consequently, as it is part of the engagement, such advice is not regarded as giving rise to any threat to the integrity, objectivity and independence of the firm and covered persons.

5.158 For listed entities that are not SME listed entities relevant to an engagement other than an investment circular reporting engagement, or significant affiliates of such entities, the threats to integrity, objectivity and independence that would be created are too high to allow the firm to provide any accounting services.
The threats to the reporting accountant’s integrity, objectivity and independence that would be created are too high to allow the firm to provide any accounting services in relation to the financial information that is the subject of an investment circular reporting engagement by the firm.

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

For entities other than listed entities that are not SME listed entities relevant to an engagement other than an investment circular reporting engagement, or significant affiliates of such listed entities, the firm may provide accounting services, provided that:

(a) such services:
   (i) do not involve initiating transactions or taking management decisions; and
   (ii) are of a technical, mechanical or an informative nature; and
(b) appropriate safeguards are applied to reduce the self-review threat to a level where independence is not compromised.

The maintenance of the accounting records and the preparation of the financial statements are the responsibility of the management of the entity. Accordingly, in any undertaking to provide the entity with accounting services, the firm does not initiate any transactions or take any decisions or make any judgments, which are properly the responsibility of the management. These include:

- authorising or approving transactions;
- preparing originating data (including valuation assumptions);
- determining or changing journal entries, or the classifications for accounts or transactions, or other accounting records without management approval.

Examples of accounting services of a technical or mechanical nature or of an informative nature include:

- recording transactions for which management has determined the appropriate account classification, posting coded transactions to the general ledger, posting entries approved by management to the trial balance or providing certain data-processing services (for example, payroll);
- assistance with the preparation of the financial statements where management takes all decisions on issues requiring the exercise of judgment and has prepared the underlying accounting records.

Examples of safeguards that may be appropriate when accounting services are provided to an entity relevant to an engagement, include:

- accounting services provided by the firm are performed by partners and staff who have no involvement in the engagement;
the accounting services are reviewed by a partner or other senior staff member with relevant expertise who is not a member of the engagement team;

• the engagement is reviewed by a partner with relevant expertise who is not involved in the engagement to ensure that the accounting services performed have been properly and effectively assessed in the context of the engagement.

Prohibited Non-audit Services for Public Interest Entities

5.165 The requirements in paragraph 5.167R below set out prohibited non-audit services for public interest entities, as established in the EU Audit Regulation. These prohibitions are applied more widely than the EU where necessary to achieve the ethical outcome of independence, having regard to supporting ethical provision 2.4. Where the work of a network firm is used in the conduct of an engagement, supporting ethical provision 2.4 stipulates that the ethical requirements that are relevant to the engagement are:

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

Accordingly, such network firms, whether or not within the Union, are also subject to the prohibitions in paragraph 5.167R for an audit engagement where any entity relevant to the engagement is a public interest entity.

5.166 The audit firm’s policies and procedures will set out whether there are circumstances in which the services specified in paragraph 5.167R are undertaken for entities that are not public interest entities as described in paragraph 1.49 of Section 1 of Part B of this Ethical Standard.

5.167R A statutory auditor or an audit firm carrying out the statutory audit of a public interest entity, or any member of the network to which the statutory auditor or the audit firm belongs, shall not directly or indirectly provide to the audited entity, to its parent undertaking or to its controlled undertakings within the Union any prohibited non-audit services in:

(a) the period between the beginning of the period audited and the issuing of the audit report; and

(b) the financial year immediately preceding the period referred to in point (a) in relation to the services listed in point (e) of the second subparagraph.

For these purposes of this Article, prohibited non-audit services shall mean:

(a) tax services relating to:

(i) preparation of tax forms;

(ii) payroll tax;

(iii) customs duties;
identification of public subsidies and tax incentives unless support from the statutory auditor or the audit firm in respect of such services is required by law;

support regarding tax inspections by tax authorities unless support from the statutory auditor or the audit firm in respect of such inspections is required by law;

calculation of direct and indirect tax and deferred tax;

provision of tax advice;

services that involve playing any part in the management or decision-making of the audited entity;

bookkeeping and preparing accounting records and financial statements;

payroll services;

designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems;

valuation services, including valuations performed in connection with actuarial services or litigation support services;

legal services, with respect to:

the provision of general counsel;

negotiating on behalf of the audited entity; and

acting in an advocacy role in the resolution of litigation;

services related to the audited entity’s internal audit function;

services linked to the financing, capital structure and allocation, and investment strategy of the audited entity, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the audited entity;

promoting, dealing in, or underwriting shares in the audited entity;

human resources services, with respect to:

management in a position to exert significant influence over the preparation of the accounting records or financial statements which are the subject of the statutory audit, where such services involve:
— searching for or seeking out candidates for such position; or
— undertaking reference checks of candidates for such positions;

(ii) structuring the organisation design; and

(iii) cost control. [AR 5.1]

5.168R By way of derogation from the second subparagraph of paragraph 1 5.167R, the services referred to in points (a)(i), (a)(iv) to (a)(vii) and (f), may be provided if the following requirements are complied with:

(a) they have no direct or, in the view of an objective, reasonable and informed third party, would have immaterial an inconsequential effect, separately or in the aggregate on the audited financial statements;

(b) the estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee referred to in Article 11; and

(c) the principles of independence laid down in Section 1 of this Ethical Standard the EU Audit Directive 2006/43/EC are complied with by the statutory auditor or the audit firm; and [AR 5.3]

(d) for the purposes of the statutory audit of the financial statements, the audit firm would not place significant reliance on the work performed by the audit firm in performing these services.

5.169 Where there are doubts about whether a service would have an inconsequential effect on the audited financial statements in the view of and objective, reasonable and informed third party, then the effect is not regarded as inconsequential.

5.170R A statutory auditor or An audit firm carrying out statutory audits of public interest entities and, where the statutory auditor or the audit firm belongs to a network, any member of such network, may provide to the audited entity, to its parent undertaking or to its controlled undertakings non-audit services other than the prohibited non-audit services referred to in paragraphs 1 and 2 5.167R subject to the approval of the audit committee after it has properly assessed threats to independence and the safeguards applied in accordance with this Ethical Standard Article 22b of the EU Audit Directive 2006/43/EC. The Audit Regulation requires that the audit committee shall, where applicable, issue guidelines with regard to the services referred to in paragraph 3 5.168R. [AR 5.4]

5.171R When a member of a network to which the statutory auditor or the audit firm carrying out a statutory audit of a public interest entity belongs provides any of the non-audit services, referred to in paragraphs 1 and 2 5.167R of this Article, to an undertaking incorporated in a third country which is controlled by the audited public interest entity, the statutory auditor or the audit firm concerned shall assess whether his, her or its
If his, her or its independence is affected, the statutory auditor or the audit firm shall apply safeguards where applicable in order to mitigate the threats caused by such provision of services in a third country. The statutory auditor or The audit firm may continue to carry out the statutory audit of the public interest entity only if he, she or it can justify, in accordance with Article 6 of this the EU Audit Regulation and Article 22b\(^{59}\) of the EU Audit Directive 2006/43/EC, that such provision of services does not affect his, her or its professional judgment and the audit report. [AR 5.5]

For the purposes of this paragraph the requirements in paragraph 5.171R and 5.172R:

(a) being involved in the decision-taking of the audited entity and the provision of the services referred to in points (b), (c) and (e) of the second subparagraph of paragraph 1 5.167R shall be deemed to affect such independence in all cases and to be incapable of mitigation by any safeguards.

(b) provision of the services referred to in the second subparagraph of paragraph 1-5.167R other than points (b), (c) and (e) thereof shall be deemed to affect such independence and therefore to require safeguards to mitigate the threats caused thereby. [AR 5.5]

\(^{59}\) See paragraph 1.74D of Section 1 of Part B of this Ethical Standard.
Section 6 – Provisions Available for Audits of Small Entities

Introduction

This Section does not apply for the audit of ‘public interest entities’.

6.1 This Ethical Standard sets out the overarching principles, supporting ethical provisions and specific requirements, that auditors are required to comply with in order to discharge their responsibilities in respect of their integrity, objectivity and independence. It addresses such matters as:

- How audit firms set policies and procedures to ensure that, in relation to each audit, the audit firm and all those who are covered persons act with integrity, objectivity and independence;
- Financial, business, employment and personal relationships;
- Long association with the audit engagement;
- Fees, remuneration and evaluation policies, litigation, gifts and hospitality;
- Non-audit services provided to audited entities.

This Ethical Standard applies to all audit firms and to all audits and must be read in order to understand the alternative provisions and exemptions contained in this Section of it.

6.2 The FRC is aware that a limited number of the requirements in Sections 1 to 5 of the Ethical Standard are difficult for certain audit firms to comply with, particularly when auditing a small entity. Whilst the FRC is clear that Sections 1 to 5 are appropriate in the interests of establishing the integrity, objectivity and independence of auditors, it accepts that certain dispensations, as set out in this Section, are appropriate to facilitate the cost effective audit of the financial statements of Small Entities (as defined below) that are not ‘public interest entities’.

6.3 This Section provides alternative provisions for auditors of Small Entities, that are not ‘public interest entities’, to apply in respect of the threats arising from economic dependence and where tax or accounting services are provided and allows the option of taking advantage of exemptions from certain of the requirements in Sections 1 to 5 for a Small Entity audit engagement. Where an audit firm takes advantage of the exemptions within this Section, it is required to:

(a) take the steps described in this Section; and
(b) disclose in the audit report the fact that the firm has applied the FRC’s Ethical Standard – Provisions Available for Audits of Small Entities.

6.4 In this Standard, for the UK a ‘Small Entity’ is:

(a) any company, which is not a UK listed company or an affiliate thereof, that qualifies as a small company under Section 382 of the Companies Act 2006;
(b) where group accounts are produced, any group that qualifies as small under Section 383 of the Companies Act 2006;

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(c) any charity with an income of less than the turnover threshold applicable to small companies as identified in Section 382 of the Companies Act 2006;

(d) any pension fund with less than 100 members (including active, deferred and pensioner members)\(^\text{60}\);

(e) any firm regulated by the FCA, which is not required to appoint an auditor in accordance with rule SUP 3.3.2R of the FCA Handbook;

(f) any credit union which is a mutually owned financial co-operative established under the Credit Unions Act 1979 and the Industrial and Provident Societies Act 1965 (or equivalent legislation), which meets the criteria set out in (a) above;

(g) any entity registered under the Industrial and Provident Societies Act 1965, incorporated under the Friendly Societies Act 1992 or registered under the Friendly Societies Act 1974 (or equivalent legislation), which meets the criteria set out in (a) above;

(h) any registered social landlord with less than 250 units; and

(i) any other entity, such as a club, which would be a Small Entity if it were a company.

Where an entity falls into more than one of the above categories, it is only regarded as a ‘Small Entity’ if it meets the criteria of all relevant categories.

**Alternative Provisions**

**Economic Dependence**

6.5 When auditing the financial statements of a Small Entity, an audit firm is not required to comply with the requirement in paragraph 4.51 of Section 4 of Part B of this Ethical Standard that an external independent quality control review is performed.

6.6 Although an external independent quality control review is not required, nevertheless the engagement partner discloses the expectation that fees will amount to between 10% and 15% of the firm’s annual fee income to the Ethics Partner and to those charged with governance of the audited entity.

**Self-review Threat – Non-audit Services**

6.7 When undertaking non-audit services for a Small Entity audited entity, the audit firm is not required to apply safeguards to address a self-review threat provided:

(a) the audited entity has ‘informed management’; and

(b) the audit firm extends the cyclical inspection of completed audit engagements that is performed for quality control purposes.

\(^{60}\) In cases where a scheme with more than 100 members has been in wind-up over a number of years, such a scheme does not qualify as a Small Entity, even where the remaining number of members falls below 100.
6.8 The audit firm extends the number of audit engagements inspected under the requirements of ISQC (UK) 1 (Revised June 2016) to include a random selection of audit engagements where non-audit services have been provided. Particular attention is given to ensuring that there is documentary evidence that ‘informed management’ has made such judgments and decisions that are needed in relation to the presentation and disclosure of information in the financial statements.

6.9 Those inspecting the audit engagements are not involved in performing the audit engagement. Small audit firms may wish to use a suitably qualified external person or another firm to carry out audit engagement inspections.

6.10 In addition to the documentation requirements of ISQC (UK) 1 (Revised June 2016), those inspecting the audit engagements document their evaluation of whether the documentary evidence that ‘informed management’ made such judgments and decisions that were needed in relation to the presentation and disclosure of information in the financial statements.

Exemptions

Management Threat – Non-audit Services

6.11 When undertaking non-audit services for Small Entity audited entities, the audit firm is not required to adhere to the prohibitions in Section 5 of Part B of this Ethical Standard relating to providing non-audit services that involve the audit firm undertaking part of the role of management, provided that:

(a) it discusses objectivity and independence issues related to the provision of non-audit services with those charged with governance, confirming that management accept responsibility for any decisions taken; and

(b) it discloses the fact that it has applied the FRC’s Ethical Standard – Provisions Available for Audits of Small Entities, in accordance with paragraph 6.15.

Advocacy Threat – Non-audit Services

6.12 The audit firm of a Small Entity is not required to comply with paragraphs 5.97 (tax services that involve acting as an advocate) and 5.140(b) (restructuring services that involve acting as an advocate) of Section 5 of Part B of this Ethical Standard, provided that it discloses the fact that it has applied the FRC’s Ethical Standard – Provisions Available for Audits of Small Entities, in accordance with paragraph 6.15.

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61 ISQC (UK) 1 (Revised June 2016) requires audit firms to establish policies and procedures which include a periodic inspection of a selection of completed engagements. Engagements selected for inspection include at least one engagement for each engagement partner over the inspection cycle, which ordinarily spans no more than three years.
Partners and Other Persons Approved as a Statutory Auditor Joining an Audited Entity

6.13 The audit firm of a Small Entity is not required to comply with paragraphs 2.53 and 2.57 of Section 2 of Part B of this Ethical Standard, provided that:

(a) it takes appropriate steps to determine that there is no significant threat to the audit team’s integrity, objectivity and independence; and

(b) it discloses the fact that it has applied the FRC’s Ethical Standard – Provisions Available for Audits of Small Entities, in accordance with paragraph 6.15.

6.14 An audit firm takes appropriate steps to determine that there is no significant threat to the audit team’s integrity, objectivity and independence as a result of the employment of a former partner, or other person approved as a statutory auditor, by an audited entity that is a Small Entity by:

(a) assessing the significance of the self-interest, familiarity or intimidation threats, having regard to the following factors:
   • the position the individual has taken at the audited entity;
   • the nature and amount of any involvement the individual will have with the audit team or the audit process;
   • the length of time that has passed since the individual was a member of the audit team or firm; and
   • the former position of the individual within the audit team or firm, and

(b) if the threat is other than clearly insignificant, applying alternative procedures such as:
   • considering the appropriateness or necessity of modifying the audit plan for the audit engagement;
   • assigning an audit team to the subsequent audit engagement that is of sufficient experience in relation to the individual who has joined the audited entity;
   • involving an audit partner or senior staff member with appropriate expertise, who, where the firm already audits the entity, was not a member of the audit team, to review the work done or otherwise advise as necessary; or
   • undertaking an engagement quality control review of the audit engagement.

Disclosure Requirements

6.15 Where the audit firm has taken advantage of an exemption provided in paragraphs 6.11, 6.12 or 6.13, the engagement partner shall ensure that:

(a) the auditors’ report discloses this fact, and

(b) either the financial statements, or the auditors’ report, discloses the type of non-audit services provided to the audited entity or the
fact that a former engagement partner, or other person personally approved as a statutory auditor, has joined the audited entity.

6.16 The fact that an audit firm has taken advantage of an exemption provided by the FRC’s Ethical Standard – Provisions Available for Small Entities is set out in a separate paragraph of the audit report. It does not affect the Opinion paragraph.

6.17 The engagement partner ensures that within the financial statements reference is made to the type of non-audit services provided to the audited entity or the fact that a former partner or other person personally approved as a statutory auditor has joined the audited entity. Where such a disclosure is not made within the financial statements it is included in the auditors’ report.
APPENDIX: Illustrative template for communicating information on audit and non-audit services provided to the group

<table>
<thead>
<tr>
<th>Service</th>
<th>Current year £m</th>
<th>Prior year £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit of company</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Audit of subsidiaries</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Total audit</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Audit related assurance services(^{62})</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Other assurance services(^{63})(^{64})</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Total assurance services</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Tax compliance services (i.e. related to assistance with corporate tax returns)</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Tax advisory services</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Services relating to taxation</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Internal audit services</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Services related to corporate finance transactions not covered above</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Other non-audit services not covered above</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Total other non-audit services</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Total non-audit services</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Total fees</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Occupational pension scheme audits</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Non-audit services in respect of the audited entity provided to a third party(^{65}).</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

\(^{62}\) This will, and will only, include those services which are identified as audit related services in paragraph 5.41 of Section 5 of Part B of this Ethical Standard.

\(^{63}\) This will not include any tax or internal audit services, all of which should be disclosed under those headings.

\(^{64}\) The definition of an assurance engagement is provided in the Glossary of Terms on the FRC’s website. Services provided under such engagements will include assurance engagements such as those which involve reporting on historical financial information which are included in an investment circular in accordance with the Standards for Investment Reporting 2000 (Revised): Investment reporting standards applicable to public reporting engagements on historical financial information.

\(^{65}\) For the purposes of this Ethical Standard, non-audit services include services provided to another entity in respect of the audited entity, for example, where the audit firm provides transaction related services, in respect of an audited entity’s financial information, to a prospective acquirer of the audited entity (see paragraph 5.8 of Section 5 of Part B of this Ethical Standard).
Disclosure of contingent fee arrangements under paragraph 4.25 of Section 4 of Part B of this Ethical Standard can also be facilitated through the use of a footnote to this template.

Disclosures required under UK company legislation\(^{66}\) are indicated by those categories in bold type above. Fuller information can be provided by companies if desired.
