APB ETHICAL STANDARD 3 (REVISED)

LONG ASSOCIATION WITH THE AUDIT ENGAGEMENT

(Revised October 2009)

Contents ***paragraph***

PREFACE

APB Ethical Standards apply in the audit of financial statements. They are read in the context of the Statement "The Financial Reporting Council - Scope and Authority of Audit and Assurance Pronouncements" which sets out the application and authority of APB Ethical Standards.

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

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

INTRODUCTION

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

(a) eliminate the threat; or

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

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

2 This Standard provides requirements and guidance on specific circumstances arising out of long association with the audit engagement, which may create threats to the auditor's objectivity or perceived loss of independence. It gives examples of safeguards that can, in some circumstances, eliminate the threat or reduce it to an acceptable level. In circumstances where this is not possible, the auditor either does not accept or withdraws from the audit engagement, as appropriate.

3 Whenever a possible or actual breach of an APB Ethical Standard is identified, the audit engagement partner, in the first instance, and the Ethics Partner, where appropriate, assesses the implications of the breach, determines whether there are safeguards that can be put in place or other actions that can be taken to address any potential adverse consequences and considers whether there is a need to resign from the audit engagement.

4 An inadvertent violation of this Standard does not necessarily call into question the audit firm's ability to give an audit opinion provided that:

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

(b) the audit engagement partner or Ethics Partner ensures that any matter which has given rise to a breach is addressed as soon as possible;

(c) safeguards, if appropriate, are applied (for example, by having another partner review the work done by the relevant partner or member of staff or by removing him or her from the engagement team): and

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

GENERAL PROVISIONS

5 **The audit firm shall establish policies and procedures to monitor the length of time that audit engagement partners, key partners involved in the audit and partners and staff in senior positions, including those from other disciplines, serve as members of the engagement team for each audit.**

6 **Where audit engagement partners, key partners involved in the audit, and partners and staff in senior positions have a long association with the audit, the audit firm shall assess the threats to the auditor's objectivity and independence and shall apply safeguards to reduce the threats to an acceptable level. Where**

appropriate safeguards cannot be applied, the audit firm shall either resign as auditor or not stand for reappointment, as appropriate.[1]

7 Where audit engagement partners, key partners involved in the audit, other partners and staff in senior positions have a long association with the audited entity, self-interest, self-review and familiarity threats to the auditor's objectivity may arise. Similarly, such circumstances may result in an actual or perceived loss of independence. The significance of such threats depends upon factors such as:

- the role of the individual in the engagement team;
- the proportion of time that the audited entity contributes to the individual's annual billable hours;
- the length of time that the individual has been associated with that audit engagement.

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

- removing ('rotating') the 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;
- applying independent internal quality reviews to the engagement in question.

9 Once an audit engagement partner has held this role for a continuous period of ten years, careful consideration is given as to whether a reasonable and informed third party would consider the audit firm's

[1] In the case of those public sector bodies where the responsibility for the audit is assigned by legislation, the auditor cannot resign from the audit engagement and considers alternative safeguards that can be put in place.

objectivity and independence to be impaired. 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 8, are applied; or

(b) (i) the reasoning as to why the individual continues to participate in the audit engagement without any safeguards is documented; and

(ii) the facts are communicated to those charged with governance of the audited entity in accordance with paragraphs 63 - 71 of APB Ethical Standard 1.

10 The audit firm's policies and procedures set out whether there are circumstances in which the audit engagement partners, engagement quality control reviewers and key partners involved in the audit of non-listed entities are subject to accelerated rotation requirements, such as those set out in paragraph 12, as described in paragraph 47 of APB Ethical Standard 1.

11 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 audit work, including the experience and continuity of members of the engagement team and the need to ensure appropriate succession planning.

ADDITIONAL PROVISIONS RELATED TO AUDITS OF LISTED COMPANIES

The audit engagement partner

12 **In the case of listed companies, save where the circumstances contemplated in paragraph 15 and 16 apply, the audit firm shall establish policies and procedures to ensure that:**

- **(a) no one shall act as audit engagement partner for more than five years; and**
- **(b) anyone who has acted as the audit engagement partner for a particular audited entity for a period of five years, shall not subsequently participate in the audit engagement until a further period of five years has elapsed.**

13 The roles that constitute participating in an audit engagement for the purposes of paragraph 12(b), include providing quality control for the engagement, advising or consulting with the engagement team or the client regarding technical or industry specific issues, transactions or events, or otherwise directly influencing the outcome of the audit engagement. This does not include responding to queries in relation to any completed audit 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 client after a period of two years has elapsed from their ceasing to act as audit 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 audit engagement partner.

14 Where an audit engagement partner continues in a non-audit role having been rotated off the engagement team, the new audit engagement partner and the individual concerned ensure that that person, while acting in this new role, does not exert any influence on the audit

engagement. Positions in which an individual is responsible for the firm's client relationship with the particular audited entity would not be an acceptable non-audit role.

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

16 In circumstances where the audit committee (or equivalent) of the audited entity decide that a degree of flexibility over the timing of rotation is necessary to safeguard the quality of the audit and the audit firm agrees, the audit 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 audit engagement partner. An audit committee and the audit firm may consider that such flexibility safeguards the quality of the audit, for example, where:

- substantial change has recently been made or will soon be made to the nature or structure of the audited entity's business; or
- there are unexpected changes in the senior management of the audited entity.

In these circumstances alternative safeguards are applied to reduce any threats to an acceptable level. Such safeguards may include ensuring that an expanded review of the audit work is undertaken by the engagement quality control reviewer or an audit partner, who is not involved in the audit engagement.

17 Where it has been determined that the audit engagement partner may act for a further period (not to exceed two years) in the interests of audit

quality, this fact and the reasons for it, are to be disclosed to the audited entity's shareholders as early as practicable and in each of the additional years. If the audited entity is not prepared to make such a disclosure, the audit firm does not permit the audit engagement partner to continue in this role.

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

Engagement quality control reviewers and key partners involved in the audit

19 **In the case of listed companies, the audit firm shall establish policies and procedures to ensure that:**

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

(b) where an engagement quality control reviewer or a key partner involved in the audit becomes the audit 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 audited entity for a period of seven years, whether continuously or in aggregate, shall not participate in the audit engagement until a further period of five years has elapsed;**

(ii) **as a key partner involved in the audit for a particular audited entity for a period of seven years, whether continuously or in aggregate, shall not participate in the audit engagement until a further period of two years has elapsed;**

(iii) **in a combination of roles as:**

- **the engagement quality control reviewer,**
- **a key partner involved in the audit, or**
- **the audit engagement partner**

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

Other partners and staff in senior positions

20 **In the case of listed companies, the audit engagement partner shall review the safeguards put in place to address the threats to the auditor's objectivity and independence arising where partners and staff have been involved in the audit 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 Partner.**

21 The significance of the threats arising where partners and staff have been involved in the audit 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 audit;
- 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 the audit and non-audit engagements with the audited entity during that period.

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

- changes in the roles within the engagement team;

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

If such safeguards do not reduce the threats to an acceptable level, the partner or member of staff is removed from the engagement team.

EFFECTIVE DATE

23 Revisions to this Ethical Standard become effective for audits of financial statements for periods commencing on or after 15 December 2009. Earlier adoption of the revisions is permitted.

24 Where a partner becomes a key partner involved in the audit as a result of the change in definition introduced with effect from 6 April 2008 the transitional arrangements in the previous version of ES 3 (Revised) continue to apply.