APB ETHICAL STANDARD 1 (REVISED)

INTEGRITY, OBJECTIVITY AND INDEPENDENCE

(Revised December 2010, updated December 2011)

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 The financial statements of an entity may have a number of different users. For example, they may be used by suppliers and customers, joint venture partners, bankers and other suppliers of finance, taxation and regulatory authorities, employees, trades unions and environmental groups. In the case of a listed company, the financial statements are an important source of information to the capital markets. But the primary purpose of the financial statements of an entity is to provide its owners – the shareholders (or those in an equivalent position) – with information on the state of affairs of the entity and its performance and to assist them in assessing the stewardship exercised by the directors (or those in an equivalent position) over the business that has been entrusted to them.

2 The financial statements of an entity are the responsibility of its board of directors and are prepared by them, or by others on their behalf, for the shareholders or, in some circumstances, for other third parties.

3 The primary objective of an audit of the financial statements is for the auditor to provide independent assurance to the shareholders that the directors have prepared the financial statements properly. The auditor issues a report that includes an opinion as to whether or not the financial statements give a true and fair view[1]. Thus the auditor assists the shareholders to exercise their proprietary powers as shareholders in the Annual General Meeting.

4 Public confidence in the operation of the capital markets and in the conduct of public interest entities depends, in part, upon the credibility of the opinions and reports issued by the auditor in connection with the audit of the financial statements. Such credibility depends on beliefs concerning the integrity, objectivity and independence of the auditor and the quality of audit work performed. APB establishes quality control, auditing and ethical standards

[1] In the case of certain bodies in the public sector, the auditor expresses an opinion as to whether the financial statements 'present fairly' the financial position.

to provide a framework for audit practice. The Auditors' Code underlies APB's standards and sets out the fundamental principles, which APB expects to guide the conduct of auditors.

5 APB Ethical Standards are concerned with the integrity, objectivity and independence of auditors. 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.

6 **Auditors shall conduct the audit of the financial statements of an entity with integrity, objectivity and independence.**

Integrity

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

8 Integrity requires that the auditor is not affected, and is not seen to be affected, by conflicts of interest. Conflicts of interest may arise from personal, financial, business, employment, and other relationships which the audit engagement team, the audit firm or its partners or staff have with the audited entity and its connected parties.[2]

9 It is important that the directors and management of an audited entity can rely on the auditor to treat the information obtained during an audit as

[2] For this purpose an audited entity's connected parties are:

a. its affiliates;
b. key members of management (including but not limited to directors and those charged with governance) of the audited entity and its significant affiliates; and
c. any person or entity with an ability to influence (other than in their capacity as professional advisor), whether directly or indirectly, key members of management and those charged with governance of the audited entity and its significant affiliates in relation to their responsibility for, or approach to, any matter or judgment that is material to the entity's financial statements.

confidential[3], unless they have authorised its disclosure, unless it is already known to third parties or unless the auditor has a legal right or duty to disclose it. Without this, there is a danger that the directors and management will fail to disclose such information to the auditor and that the effectiveness of the audit will thereby be impaired.

Objectivity

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

11 The need for auditors to be objective arises from the fact that many of the important issues involved in the preparation of financial statements do not relate to questions of fact but rather to questions of judgment. For example, 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. If the directors, whether deliberately or inadvertently, make a biased judgment or an otherwise inappropriate decision, the financial statements may be misstated or misleading.

[3] The fundamental principle of confidentiality is addressed in the ethical guidance issued by the auditor's professional accountancy body. This principle does not constrain the proper communication between the auditor and shareholders (or equivalent) of the audited entity.

12 It is against this background that the auditor is required to express an opinion on the financial statements. The audit involves considering the process followed and the choices made by the directors in preparing the financial statements and concluding whether the result gives a true and fair view. The auditor's objectivity requires that an impartial opinion is expressed in the light of all the available audit evidence and the auditor's professional judgment. Objectivity also requires that the auditor adopts a rigorous and robust approach and is prepared to disagree, where necessary, with the directors' judgments.

Independence

13 Independence is freedom from situations and relationships which make it probable that a reasonable and informed third party would conclude that objectivity either is impaired or could be impaired. Independence is related to and underpins objectivity. However, whereas objectivity is a personal behavioural characteristic concerning the auditor's state of mind, independence relates to the circumstances surrounding the audit, including the financial, employment, business and personal relationships between the auditor and the audited entity and its connected parties. Relationships with parties whose interests may be contrary to the interests of the audited entity (for example, a hostile bidder) may also be relevant to the appearance of the auditor's independence.

14 The need for independence arises because, in most cases, users of the financial statements and other third parties do not have all the information necessary for judging whether the auditor is, in fact, objective. Although the auditor may be satisfied that the auditor's objectivity is not impaired by a particular situation, a third party may reach a different conclusion. For example, if a third party were aware that the auditor had certain financial, employment, business or personal relationships with the audited entity, that individual might reasonably conclude that the auditor could be subject to undue influence from the directors or would not be impartial or unbiased.

Public confidence in the auditor's objectivity could therefore suffer as a result of this perception, irrespective of whether there is any actual impairment.

15 Accordingly, in evaluating the likely consequences of such situations and relationships, the test to be applied is not whether the auditor considers that the auditor's objectivity is impaired but whether it is probable that a reasonable and informed third party would conclude that the auditor's objectivity either is impaired or is likely to be impaired. As a result of the influence that the board of directors and management have over the appointment and remuneration of the auditor absolute independence cannot be achieved or maintained. The audit engagement partner considers the application of safeguards where there are threats to auditor independence (both actual and perceived).

COMPLIANCE WITH ETHICAL STANDARDS

16 **The audit firm shall establish policies and procedures, appropriately documented and communicated, designed to ensure that, in relation to each audit engagement, the audit firm, and all those who are in a position to influence the conduct and outcome of the audit, act with integrity, objectivity and independence.**

17 For the purposes of APB Ethical Standards, a person in a position to influence the conduct and outcome of the audit is:

(a) any person who is directly involved in the audit ('the engagement team'), including:

(i) the audit partners, audit managers and audit staff ('the audit team');

(ii) professional personnel from other disciplines involved in the audit (for example, lawyers, actuaries, taxation specialists, IT specialists, treasury management specialists);[4]

(iii) those who provide quality control or direct oversight of the audit;

(b) any person who forms part of the chain of command for the audit within the audit firm;

(c) any person within the audit firm who, due to any other circumstances, may be in a position to exert such influence.

18 Compliance with the requirements regarding the auditor's integrity, objectivity and independence is a responsibility of both the audit firm and of individual partners and professional staff. The audit firm establishes policies and procedures, appropriate to the size and nature of the audit firm, to promote and monitor compliance with those requirements by any person who is in a position to influence the conduct and outcome of the audit.[5, 6]

19 **The leadership of the audit firm shall take responsibility for establishing a control environment within the firm that places adherence to ethical principles and compliance with APB Ethical Standards above commercial considerations.**

20 The leadership of the audit firm influences the internal culture of the firm by its actions and by its example ('the tone at the top'). Achieving a robust

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[4] Where external consultants are involved in the audit, ISA (UK and Ireland) 620 *'Using the Work of an Auditor's Expert'* states that the auditor shall evaluate the objectivity of the expert.

[5] Monitoring of compliance with ethical requirements will often be performed as part of a broader quality control process. ISQC (UK & Ireland) 1 *'Quality Control for Firms that Perform Audits and Reviews of Financial Statements and other Assurance and Related Services Engagements*' establishes requirements in relation to a firm's responsibilities for its system of quality control for audits.

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

control environment requires that the leadership gives clear, consistent and frequent messages, backed up by appropriate actions, which emphasise the importance of compliance with APB Ethical Standards.

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

(a) requirements for partners and staff to report where applicable:
- family and other personal relationships involving an entity audited by the firm;
- financial interests in an entity audited by the firm;
- decisions to join an audited 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 audit engagement partners' documentation of the consideration of the auditor's objectivity and independence, addressing, for example:
- financial interests in audited entities;
- economic dependence on audited entities;
- the performance of non-audit services;
- audit partner rotation;

(c) identification of the audited entities which partners in the chain of command and their immediate family need to be independent from[7];

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

(e) evaluation by audit 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 audit engagement partners of particular circumstances or relationships as required by APB Ethical Standards;

[7] Such identification is necessary for those in the chain of command to understand how their firm responsibilities result in connections with different entities audited by the firm. It can be achieved by listing the individual audited entities or by a broader statement regarding categories of audited entity, for example, those of a certain business unit.

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

(h) empowerment of staff to communicate to senior levels within the firm any issue of objectivity or independence that concerns them; this includes establishing clear communication channels open to staff, encouraging staff to use these channels and ensuring that staff who use these channels are not subject to disciplinary proceedings as a result.

22 **Save where the circumstances contemplated in paragraph 26 apply, the audit firm shall designate a partner in the firm ('the Ethics Partner') as having responsibility for:**

(a) the adequacy of the firm's policies and procedures relating to integrity, objectivity and independence, its compliance with APB Ethical Standards, and the effectiveness of its communication to partners and staff on these matters within the firm; and

(b) providing related guidance to individual partners with a view to achieving a consistent approach to the application of the APB Ethical Standards.

23 In this role, the Ethics Partner has particular responsibility for engendering a culture in which the audit firm approaches ethical issues following the principles in the Ethical Standards. The Ethics Partner is an individual possessing seniority, relevant experience, and authority at leadership levels within the audit firm. Where the Ethics Partner undertakes this role together with a role such as Compliance or Risk Management he or she ensures that the responsibilities of the Ethics Partner set out in paragraph 22 above take precedence over the responsibilities of other functions.

24 In the case of audit firms that audit listed companies, the Ethics Partner has direct access to the independent non-executives[8] where such roles are

[8] Independent non-executives appointed in accordance with the Audit Firm Governance Code are not regarded as part of the Chain of Command for the purposes of these Ethical Standards.

introduced in an audit firm or, alternatively, to the firm's most senior governance body.

25 In assessing the effectiveness of the firm's communication of its policies and procedures relating to integrity, objectivity and independence, Ethics Partners consider whether the ethics are covered properly in induction programmes, professional training and continuing professional development for all partners and staff. Ethics Partners also provide guidance on matters referred to them and on matters which they otherwise become aware of, where a difficult and objective judgment needs to be made or a consistent position reached. Ethics Partners are proactive in considering the ethical implications of developments in the business of the audit firm and the environment in which it operates and in providing advice and guidance to partners and staff where appropriate.

26 In audit firms with three or fewer partners who are 'responsible individuals'[9], it may not be practicable for an Ethics Partner to be designated. In these circumstances all partners will regularly discuss ethical issues amongst themselves, so ensuring that they act in a consistent manner and observe the principles set out in APB Ethical Standards. 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 auditor's professional body, or through discussion with a practitioner from another firm. In all cases, it is important that such discussions are documented.

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

- the provision of guidance on those audits where the Ethics Partner is the audit engagement partner; and

[9] A 'responsible individual' is a partner or employee of the audit firm who is responsible for audit work and designated as such under the audit regulations of a Recognised Supervisory Body.

- situations where the Ethics Partner is unavailable, for example due to illness or holidays.

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

- matters delegated to support staff 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.

28 Whenever a possible or actual breach of an APB Ethical Standard, or of policies and procedures established pursuant to the requirements 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.

29 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 promptly notifies the relevant partner or member of staff that any matter which has given rise to a breach is to be addressed as soon as possible and ensures that such action is taken;

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

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

IDENTIFICATION AND ASSESSMENT OF THREATS

30 The auditor identifies and assesses the circumstances which could adversely affect the auditor's objectivity ('threats'), including any perceived loss of 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 audited entity); 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 is impaired or is likely to be impaired (for example, by having the audit work reviewed by another partner or by another audit firm).

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.

Threats to objectivity and independence

31 **The audit firm shall establish policies and procedures to require persons in a position to influence the conduct and outcome of the audit to be constantly alert to circumstances that might reasonably be considered threats to their objectivity or the perceived loss of independence and, where such circumstances are identified, to report**

them to the audit engagement partner or to the Ethics Partner, as appropriate.

32 Such policies and procedures require that threats to the auditor's objectivity and independence 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[10] basis and the action taken is documented. If the audit engagement partner is personally involved, or is unsure about the action to be taken, the matter is resolved through consultation with the Ethics Partner.

33 **The audit firm shall establish policies and procedures which require that partners and employees of the firm, including those providing non-audit services to an audited entity or its affiliates, do not take decisions that are the responsibility of management of the audited entity.**

34 It is not possible to specify all types of decision that are the responsibility of management, but they typically involve leading and directing the audited entity, including making significant judgments and taking decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources. Examples of judgments and decisions that are not made by the auditor 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 audit firm or other third parties should be implemented;

[10] 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.

- Taking responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; and
- Taking responsibility for designing, implementing and maintaining internal control.

35 The principal types of threats to the auditor's objectivity and independence are:

- ***self-interest threat***

  A self-interest threat arises when the auditor has financial or other interests which might cause the auditor to be reluctant to take actions that would be adverse to the interests of the audit firm or any individual in a position to influence the conduct or outcome of the audit (for example, where the auditor has an investment in the audited entity, is seeking to provide additional services to the audited entity or needs to recover long-outstanding fees from the audited entity).
- ***self-review threat***

  A self-review threat arises when the results of a non-audit service performed by the auditor or by others within the audit firm are reflected in the amounts included or disclosed in the financial statements (for example, where the audit firm has been involved in maintaining the accounting records, or undertaking valuations that are incorporated in the financial statements). In the course of the audit, the auditor may need to re-evaluate the work performed in the non-audit service. As, by virtue of providing the non-audit service, the audit firm is associated with aspects of the preparation of the financial statements, the auditor may be (or may be perceived to be) unable to take an impartial view of relevant aspects of those financial statements.
- ***management threat***

  Paragraph 30 prohibits partners and employees of the audit firm from taking decisions on behalf of the management of the audited entity. A management threat can also arise when the audit firm undertakes an engagement to provide non-audit services in relation to which management are required to make judgments and take decisions based on that work (for example, the design, selection and implementation of a financial information technology system). In such work, the audit firm may become closely aligned with the views and interests of management and the auditor's objectivity and independence may be impaired, or may be perceived to be, impaired.

- ***advocacy threat***

  An advocacy threat arises when the audit firm undertakes work that involves acting as an advocate for an audited entity and supporting a position taken by management in an adversarial context (for example, by acting as a legal advocate for the audited entity in litigation or a regulatory investigation). In order to act in an advocacy role, the audit firm has to adopt a position closely aligned to that of management. This creates both actual and perceived threats to the auditor's objectivity and independence.

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

  A familiarity (or trust) threat arises when the auditor is predisposed to accept, or is insufficiently questioning of, the audited entity's point of view (for example, where close personal relationships are developed with the audited entity's personnel through long association with the audited entity).

- ***intimidation threat***

  An intimidation threat arises when the auditor's conduct is influenced by fear or threats (for example, where the auditor encounters an aggressive and dominating individual).

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

36 Threats to the auditor's objectivity, including a perceived loss of independence, may arise where the audit firm is appointed to a non-audit service engagement for an entity not audited by the firm, but where an audited entity makes this decision. In such cases, even if the entity not audited by the firm pays the fee for the non-audit service engagement, the auditor considers the implication of the threats (especially the self-interest threat) that arise from the appointment.

37 Similarly threats may arise where the auditor has a relationship with any connected party of the audited entity. Where any member of the engagement team is aware of such relationships, an assessment of the threats and available safeguards is made.

38 **The audit firm shall establish policies and procedures to require the audit engagement partner to identify and assess the significance of threats to the auditor's objectivity on an individual and cumulative[10] basis, including any perceived loss of independence:**

(a) when considering whether to accept or retain an audit engagement;[11]

(b) when planning the audit;

(c) when forming an opinion on the financial statements;[12]

(d) when considering whether to accept or retain an engagement to provide non-audit services to an audited entity; and

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

39 An initial assessment of the threats to objectivity and independence is required when the audit engagement partner is considering whether to accept or retain an audit engagement. That assessment is reviewed and

[11] Consideration of whether to accept or retain an audit engagement does not arise with those bodies in the public sector where responsibility for the audit is assigned by legislation.

[12] In the case of listed companies, the auditor also assesses whether there is any threat to the auditor's objectivity and independence when discharging responsibilities in relation to preliminary announcements and when reporting on interim results.

updated at the planning stage of each audit. At the end of the audit process, when forming an opinion on the financial statements but before issuing the report, the audit engagement partner draws an overall conclusion as to whether all threats to objectivity and independence have been properly addressed on an individual and cumulative basis in accordance with APB Ethical Standards. If, at any time, the auditor is invited to accept an engagement to provide non-audit services, the audit engagement partner considers the impact this may have on the auditor's objectivity and independence.

40 When identifying and assessing threats to the auditor's objectivity and independence, the audit engagement partner takes into account current relationships with the audited entity (including non-audit service engagements and known relationships with connected parties of the audited entity) and with other parties in certain circumstances (see paragraph 41), those that existed prior to the current audit engagement and any known to be in prospect following the current audit engagement. This is because those prior and subsequent relationships may be perceived as likely to influence the auditor in the performance of the audit or as otherwise impairing the auditor's objectivity and independence.

41 Threats to the auditor's objectivity, including a perceived loss of independence, may arise where a non-audit service is provided by the audit firm to a third party which is connected (through a relationship) to an audited entity, and the outcome of that service has a material impact on the financial statements of the audited entity. For example, if the audit firm provides actuarial services to the pension scheme of an audited entity, which is in deficit, and the audit firm subsequently gives an opinion on financial statements that include judgments given in connection with that service.

42 Where the audited entity or a third party calls into question the objectivity and independence of the audit firm in relation to a particular audited entity, the Ethics Partner carries out such investigations as may be appropriate.

IDENTIFICATION AND ASSESSMENT OF SAFEGUARDS

43 **If the audit engagement partner identifies threats to the auditor's objectivity, including any perceived loss of 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 an acceptable level.**

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

45 Other APB Ethical Standards address specific circumstances which can create threats to the auditor's objectivity or loss of independence. They give examples of safeguards that can, in some circumstances, eliminate the threat or reduce it to an acceptable level. In circumstances where this is not possible, the auditor either does not accept or withdraws from the audit engagement as appropriate.

46 APB Ethical Standards contain certain additional requirements or prohibitions that apply only in the case of listed company audited entities:

- ES 1, paragraphs 51 and 67;
- ES 3, paragraphs 12, 19 and 20;
- ES 4, paragraphs 22, 31 and 35;
- ES 5, paragraphs 28, 77, 84, 99, 110, 117, 153 and 160.

These additional requirements also apply where regulation or legislation requires that the audit of an entity is conducted in accordance with the auditing standards or ethical requirements that are applicable to the audit of listed companies.

47 **The audit firm shall establish policies and procedures which set out the circumstances in which those additional requirements listed in paragraph 46 that apply to listed companies are applied to other audit engagements.**

48 Such policies and procedures take into consideration any additional criteria set by the audit firm, such as the nature of the entity's business, its size, the number of its employees and the range of its stakeholders. For example, a firm may decide to extend the additional requirements to audit engagements of certain regulated financial institutions such as large non-listed banks and insurance companies.

49 **The audit engagement partner shall not accept or shall not continue an audit engagement if he or she concludes that any threats to the auditor's objectivity and independence cannot be reduced to an acceptable level.**

50 Where a reasonable and informed third party would regard ceasing to act as the auditor as detrimental to the shareholders (or equivalent) of the audited entity, then resignation may not be immediate. However, the audit firm discloses full details of the position to those charged with governance of the audited entity, and establishes appropriate safeguards.

ENGAGEMENT QUALITY CONTROL REVIEW

51 **In the case of listed companies the engagement quality control reviewer [13] shall:**

[13] ISA (UK and Ireland) 220 *'Quality Control for an Audit of Financial Statements'*, requires the audit engagement partner to determine that an engagement quality control reviewer has been appointed for all audits of listed entities. The engagement quality control review involves consideration of the engagement team's evaluation of the firm's independence in relation to the audit engagement.

(a) consider the audit firm's compliance with APB Ethical Standards in relation to the audit engagement;

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

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

52 The audit firm's policies and procedures set out whether there are circumstances in which an engagement quality control review is performed for other audit engagements as described in paragraph 47.

53 Where the involvement of an engagement quality control reviewer provides a safeguard to reduce to an acceptable level those threats to independence that have been identified as potentially arising from the provision of non-audit services, his or her review specifically addresses the related threat by ensuring that the work that was performed in the course of the non-audit service engagement has been properly and effectively assessed in the context of the audit of the financial statements.

OVERALL CONCLUSION

54 **At the end of the audit process, when forming an opinion but before issuing the report on the financial statements, the audit engagement partner shall reach an overall conclusion that any threats to objectivity and independence on an individual and cumulative basis have been properly addressed in accordance with APB Ethical Standards. If the audit engagement partner cannot make such a conclusion, he or she shall not report and the audit firm shall resign as auditor.**

55 In addition to assessing individual threats to auditor objectivity and independence, the audit engagement partner assesses the cumulative

impact of all the threats identified on the audit engagement so as to reach a conclusion that the threats identified, when viewed individually and cumulatively, have been reduced to an acceptable level through the application of safeguards.

56 If the audit engagement partner remains unable to conclude that any individual threats to objectivity and independence, or all threats to objectivity and independence viewed on a cumulative basis, have been properly addressed in accordance with APB Ethical Standards, or if there is a disagreement between the audit engagement partner and the engagement quality control reviewer, he or she consults the Ethics Partner.

57 In concluding on compliance with the requirements for objectivity and independence, the audit engagement partner is entitled to rely on the completeness and accuracy of the data developed by the audit firm's systems relating to independence (for example, in relation to the reporting of financial interests by staff), unless informed otherwise by the firm.

OTHER AUDITORS INVOLVED IN THE AUDIT OF GROUP FINANCIAL STATEMENTS

58 **The group audit engagement partner shall be satisfied that other auditors (whether a network firm or another audit firm) involved in the audit of the group financial statements, who are not subject to APB Ethical Standards, are objective and document the rationale for that conclusion.**

59 The group audit engagement partner obtains appropriate evidence[14] that the other auditors have a sufficient understanding of and have complied with the

[14] ISA (UK and Ireland) 600 *'Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)'* requires that the group engagement team shall

current Code of Ethics for Professional Accountants, including the independence requirements[15].

60 In the case of a listed company, the group audit engagement partner establishes that the company has communicated its policy[16] on the engagement of the external auditor to supply non-audit services to its affiliates and obtains confirmation that the other auditors will comply with this policy.

NETWORK FIRMS NOT INVOLVED IN THE AUDIT

61 **The audit firm shall establish that network firms which are not involved in the audit are required to comply with global policies and procedures that are designed to meet the requirements of the current IESBA Code**[15].

62 The IESBA Code requires all network firms to be independent of the entities audited by other network firms[17]. International audit networks commonly meet this requirement through global independence policies and procedures

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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.

[15] The Code of Ethics for Professional Accountants (the IESBA Code) issued by the International Ethics Standards Board for Accountants establishes a conceptual framework for applying the fundamental principles of professional ethics for professional accountants. Section 290 of the IESBA Code illustrates the application of the conceptual framework to independence requirements for audit engagements and represents the international standard on which national standards should be based. No Member Body of the International Federation of Accountants (IFAC) is allowed to apply less stringent standards than those stated in that section. In addition, members of the IFAC Forum of Firms have agreed to apply ethical standards, which are at least as rigorous as those of the IESBA Code.

[16] 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.

[17] Paragraph 290.13 of the IESBA Code, as updated in July 2009.

designed to comply with the current IESBA Code which are supported by appropriate monitoring and compliance processes within the network.

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

63 **The audit engagement partner shall ensure that those charged with governance of the audited entity are appropriately informed on a timely basis of all significant facts and matters that bear upon the auditor's objectivity and independence.**

64 The audit committee, where one exists, is usually responsible for oversight of the relationship between the auditor and the entity and of the conduct of the audit process. It therefore has a particular interest in being informed about the auditor's ability to express an objective opinion on the financial statements. Where there is no audit committee, this role is undertaken by the board of directors.[18, 19]

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

- the principal threats, if any, to objectivity and independence identified by the auditor, including consideration of all relationships between the audited entity, its affiliates and directors and the audit 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 audit firm for maintaining objectivity and independence.

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[18] Where there is no audit committee, references to communication with the audit committee are to be construed as including communication with the board of directors.

[19] Some bodies in the public sector have audit committees but others have different governance models.

66 Communications between the auditor and those charged with the governance of the audited entity will be needed at the planning stage and whenever significant judgments are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

Additional provisions related to audits of listed companies

67 **In the case of listed companies, the audit engagement partner shall ensure that the audit committee is provided with:**

(a) a written disclosure of relationships (including the provision of non-audit services) that bear on the auditor's objectivity and independence, the threats to auditor independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable the auditor's objectivity and independence to be assessed;

(b) details of non-audit services provided and the fees charged in relation thereto;

(c) written confirmation that the auditor is independent;

(d) details of any inconsistencies between APB Ethical Standards and the company's policy for the supply of non-audit services by the audit firm and any apparent breach of that policy.

(e) an opportunity to discuss auditor independence issues.

68 The most appropriate time for these final written confirmations of independence is usually at the conclusion of the audit.

69 The auditor of a listed company discloses in writing details of all relationships between the auditor and the audited entity, and its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the audited entity, its directors and senior management and its affiliates, and other services provided to other known connected parties that the auditor considers may reasonably be thought to

bear on the auditor's objectivity and independence and the related safeguards that are in place

70 The auditor ensures that the total amount of fees that the auditor 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 contains an illustrative template for the provision of such information to an audit committee[20]. Separately, the auditor provides information on any contingent fee arrangements[21], 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.

71 The written confirmation that the auditor is independent indicates that the auditor considers that the audit firm complies with APB Ethical Standards and that, in the auditor's professional judgment, the audit firm is independent and its objectivity is not compromised. If it is not possible to make such a confirmation, the communication will include any concerns that the auditor has that the audit firm's objectivity and independence may be compromised (including instances where the group audit engagement partner does not consider an other auditor to be objective) and an explanation of the actions which necessarily follow from this.

DOCUMENTATION

72 **The audit engagement partner shall ensure that his or her consideration of the auditor's objectivity and independence is appropriately documented on a timely basis.**

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

[21] Paragraph 22 of ES 4 requires the audit engagement partner to disclose to the audit committee, in writing, any contingent fee arrangements for non-audit services provided by the auditor or its network firms.

73 The requirement to document these issues contributes to the clarity and rigour of the audit engagement partner's thinking and the quality of his or her judgments. In addition, such documentation provides evidence that the audit engagement partner's consideration of the auditor's objectivity and independence was properly performed and, for listed companies, provides the basis for review by the engagement quality control reviewer.

74 Matters to be documented[22] 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;
- safeguards adopted and the reasons why they are considered to be effective;
- review by an engagement quality control reviewer or an independent partner;
- overall assessment of threats, on an individual and cumulative basis, and safeguards; and
- communication with those charged with governance.

[22] The necessary working papers can be combined with those prepared pursuant to paragraph 24 of ISA (UK and Ireland) 220 *'Quality Control for an Audit of Financial Statements'*, which requires that: "The auditor shall include in the audit documentation conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions."

EFFECTIVE DATE

75 This revised Ethical Standard becomes effective on 30 April 2011.

76 Firms may complete audit engagements relating to periods commencing on or before 31 December 2010 in accordance with existing ethical standards, putting in place any necessary changes in the subsequent engagement period.

APPENDIX: Illustrative template for communicating information on audit and non-audit services provided to the group

	Current year £m	Prior year £m
Audit of company	X	X
Audit of subsidiaries	X	X
Total audit	X	X
Audit related assurance services[23]	X	X
Other assurance services[24 25]	X	X
Total assurance services	X	X
Tax compliance services (i.e. related to assistance with corporate tax returns)	X	X
Tax advisory services	X	X
Services relating to taxation	X	X
Internal audit services	X	X
Services related to corporate finance transactions not covered above	X	X
Other non-audit services not covered above	X	X
Total other non-audit services	X	X
Total non-audit services	X	X
Total fees	X	X
Occupational pension scheme audits	X	X
Non-audit services in respect of the audited entity provided to a third party[26].	X	X

Disclosure of contingent fee arrangements under paragraph 22 of ES 4 can also be facilitated through the use of a footnote to this template.
Disclosures required under UK company legislation[27] are indicated by those categories in bold type above. Fuller information can be provided by companies if desired.

[23] This will, and will only, include those services which are identified as audit related services in paragraph 55 of ES 5.
[24] This will not include any tax or internal audit services, all of which should be disclosed under those headings.
[25] The definition of an assurance engagement is provided in the Glossary of Terms included in APB's Compendium of Standards and Guidance which is published annually. 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.
[26] For the purposes of APB Ethical Standards 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 12 of ES 5).
[27] Disclosure requirements in the Republic of Ireland are set out in European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010. An information sheet on this topic "Disclosure of auditors' remuneration" was developed by the Consultative Committee of Accountancy Bodies in Ireland and published by Chartered Accountants Ireland in January 2011: this is available at: http://www.charteredaccountants.ie/Members/Technical1/Financial-Reporting/Resources/Disclosure-of-Auditor-Remuneration/ .