

STAFF GUIDANCE NOTE 04/2016

Ethical Implications of a Power of Attorney

This Guidance Note seeks to place on record the FRC's understanding of the ethical implications arising from holding a power of attorney, in view of the enhanced personal financial independence requirements contained in the Audit Directive, and included in the Ethical Standard at paragraphs 2.3D and 2.4D. In relation to the prohibitions on holding financial interests and engaging in any transaction in financial instruments of the types referred to in those paragraphs, the prohibitions apply where those holdings or transactions, or the ability to influence the investment policies of an intermediary, are controlled, engaged in or arise by virtue of a power of attorney

An audit firm, each of the firm's key audit partners, each directly involved covered person for any engagement and any persons closely associated with the audit firm, any such partner or covered person may not, therefore, control investments including through a power of attorney, where these investments represent direct, direct beneficial or indirect interests of a partner, covered person or persons closely associated with them in an entity audited by a firm.

In the case of assets controlled under a Power of Attorney, audit firms should consider, in respect of the individual holding the Power of Attorney, whether either: (i) any of the financial interests over which they hold Power of Attorney is of a type covered by the requirements of 2.3D or 2.4D; or (ii) in exercising the Power of Attorney, the individual has engaged in any transaction in any asset over which they hold the Power of Attorney that is such a financial interest. In addition, it would be necessary to consider the implications of paragraphs 2.18-2.20 which relates to financial interests held in a trustee capacity.

Assets that are financial instruments of a type covered by 2.4D, over which such an individual holds a Power of Attorney, are prohibited. This is because such interests are held through an intermediary (the 'living estate' of the individual whose Power of Attorney they hold) which they control. Where the individual is a potential beneficiary of that estate (for example, under a will) any financial interest in which they have a beneficial interest could be either a direct financial interest, if the estate has an ownership or direct beneficial interest, or an indirect financial interest, if the estate holds a beneficial interest through an intermediary over which the estate does not have control or significant influence.

As a result, audit firms need to ensure that they place a requirement on their staff to notify the firm of any powers of attorney they (or persons closely associated to them) hold, and the point at which they come into force, so that the audit firm can take necessary action, or provide staff members with appropriate advice to avoid a power of attorney resulting in a breach of the Ethical Standard.

In putting into place appropriate policies, audit firms need to consider that the independence of the holder of a Power of Attorney which has not yet been activated, may still pose a risk of a breach because that individual may be perceived to have a growing ability to influence the way in which the assets held under a Power of Attorney are invested.

Where the individual holding the Power of Attorney has no beneficial interest in the assets of the estate, the requirements of ES 2.18-2.20 relating to financial interests held in a trustee capacity should be considered because we believe there is a strong analogy between acting as a trustee and holding a Power of Attorney.

Holdings in a trustee capacity may be prohibited even when the individual acting in that capacity has no existing beneficial interests in the assets over which they have control, for example where:

- the holder of the Power of Attorney may be an ultimate beneficiary of the 'living estate'/ trust; or
- the financial interest in an entity was material to the 'living estate'/ trust overall; or
- the holder of a Power of Attorney, is able to exert significant influence over an entity or an affiliate of that entity; or
- the holder of the Power of Attorney has significant influence over the way in which those assets are invested.

The Ethical Standard states that in respect of the matters covered in paragraphs ES 2.3-2.5 threats cannot be eliminated or reduced by other safeguards to a level where they would not compromise independence (ES 2.6). As the requirements in ES 2.3 are applicable to all partners in the audit firm, they cannot be addressed by removing a partner from an engagement or area of activity. Should, therefore, prohibited financial interests controlled under a Power of Attorney by a partner or a closely associated person of a partner, in an entity subject to an audit or other public interest assurance engagement by a firm, not be disposed of this would result in a breach of the Ethical Standard. Where financial interests are divested this should take place as soon as possible after the individual controlling them under a Power of Attorney becomes able to make a disposal.

Audit firms should also consider their policies and procedures which make up their control environment to ensure that they adequately cover financial interests held under a Power of Attorney.