

# APB ETHICAL STANDARD 2 (REVISED)

## FINANCIAL, BUSINESS, EMPLOYMENT AND PERSONAL RELATIONSHIPS

*(Revised December 2010)*

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## **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 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 financial, business, employment and personal relationships with the audited entity, 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, either the relationship in question is not entered into or 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 promptly notifies the 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, if appropriate, are applied (for example, 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.

## **FINANCIAL RELATIONSHIPS**

### **General considerations**

- 5 A financial interest is an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such an interest.
- 6 Financial interests may be:
  - (a) owned directly, rather than through intermediaries (a 'direct financial interest'); or
  - (b) owned through intermediaries, for example, an open ended investment company or a pension scheme (an 'indirect financial interest').

- 7 **Save where the circumstances contemplated in paragraphs 9, 10, 12, 19 or 21 apply, the audit firm, any partner in the audit firm, a person in a position to influence the conduct and outcome of the audit or an immediate family member of such a person shall not hold:**
- (a) any direct financial interest in an audited entity or an affiliate of an audited entity; or**
  - (b) any indirect financial interest in an audited entity or an affiliate of an audited entity, where the investment is material to the audit firm or the individual, or to the intermediary; or**
  - (c) any indirect financial interest in an audited entity or an affiliate of an audited 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 investment in the audited entity.**
- 8 The threats to the auditor's objectivity and independence, where a direct financial interest or a material indirect financial interest in the audited entity is held by the audit firm or by one of the individuals specified in paragraph 7, are such that no safeguards can eliminate them or reduce them to an acceptable level.
- 9 Where a person joins the audit firm as a partner, he or she or an immediate family member is not required to dispose of financial interests held where:
- (a) the financial interests were acquired before the new partner joined the audit firm; and
  - (b) the individual is not able to influence the affairs of the audited entity; and
  - (c) either there is no market for such interests, or the individual does not have the power to sell or direct the sale of the interest; and
  - (d) the new partner:

- is not in a position to influence the conduct and outcome of the audit;
- does not work in the same part of the firm as the audit engagement partner; and
- is not involved in the provision of a non-audit service to the audit client.

Such a financial interest is disposed of as soon as possible after the individual becomes able to make a disposal. The audit firm ensures that:

- such financial interests are approved by the Ethics Partner;
- a record is maintained of such individuals, including a description of the circumstances; and
- this information is communicated to the relevant audit engagement partner.

10 Where an immediate family member of a partner who is not in a position to influence the conduct and outcome of the audit holds a financial interest in an audited entity or an affiliate of an audited entity as a consequence of:

- their compensation arrangements (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 immediate family member has a contractual business or employment arrangement (for example, a partnership agreement);

such financial interests are not generally considered to threaten the auditor's objectivity and independence. However, where such interests are significant or the relevant partner has close working contacts with the engagement team, the Ethics Partner considers whether any safeguards need to be put in place.

11 For the purposes of paragraph 7, where holdings in an authorised unit or investment trust, an open ended investment company or an equivalent investment vehicle which is audited by the audit firm, are held by a

partner in the audit firm, who is not in a position to influence the conduct and outcome of the audit, or an immediate family member of such a partner, these 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 audited entity.

12 Where a person in a position to influence the conduct and outcome of the audit or a partner in the audit firm, or any of their immediate family members are members or shareholders of an audited entity, as a result of membership requirements, or equivalent, the audit firm ensures that no more than the minimum number of shares necessary to comply with the requirement are held and that this shareholding is not material to either the audited entity or the individual. Disclosure of such shareholdings will be made to those charged with governance of the audited entity, in accordance with APB Ethical Standard 1, paragraph 63.

- 13 Where one of the financial interests specified in paragraph 7 is held by:
- (a) *the audit firm, a partner in the audit firm or an immediate family member of such a partner:* the entire financial interest is disposed of, a sufficient amount of an indirect financial interest is disposed of so that the remaining interest is no longer material, or the firm does not accept (or withdraws from) the audit engagement;
  - (b) *a person in a position to influence the conduct and outcome of the audit:* the entire financial interest is disposed of, a sufficient amount of an indirect financial interest is disposed of so that the remaining interest is no longer material, or that person does not retain a position in which they exert such influence on the audit engagement;
  - (c) *an immediate family member of a person in a position to influence the conduct and outcome of the audit:* the entire financial interest is disposed of, a sufficient amount of an indirect financial interest is disposed of so that the remaining interest is no longer material,

or the person in a position to influence the conduct and outcome of the audit does not retain a position in which they exert such influence on the audit engagement.

- 14 Where one of the financial interests specified in paragraph 7 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.
- 15 Where the disposal of a financial interest does not take place immediately, the audit firm adopts safeguards to preserve its objectivity until the financial interest is disposed of. These may include the temporary exclusion of the person in a position to influence the conduct and outcome of the audit from such influence on the audit, or a review of the relevant person's audit work by an audit partner having sufficient experience and authority to fulfill the role who is not involved in the audit engagement.
- 16 Where the audit firm or one of the individuals specified in paragraph 7 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 audited entity;
- there may not be a threat to the auditor's objectivity and independence. For example, where the indirect financial interest takes the form of an investment in a pension fund, the composition of the funds and the size and nature of any underlying investment in the audited 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 audited entity is determined by the composition of the relevant index and there may be no threat to objectivity. As long as the person holding the

indirect interest is not directly involved in the audit of the intermediary, nor able to influence the individual investment decisions of the intermediary, any threat to the auditor's objectivity and independence may be regarded as insignificant.

- 17 Where the audit firm or one of the individuals specified in paragraph 7 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 audited entity, this means that they are unaware of the existence of an indirect financial interest. In these circumstances, there is no threat to the auditor's objectivity and independence.
- 18 **Where a person in a position to influence the conduct and outcome of the audit or a partner in the audit firm becomes aware that a close family member holds one of the financial interests specified in paragraph 7, that individual shall report the matter to the audit engagement partner to take appropriate action. If it is a close family member of the audit engagement partner, or if the audit engagement partner is in doubt as to the action to be taken, the audit engagement partner shall resolve the matter through consultation with the Ethics Partner.**

### **Financial interests held as trustee**

- 19 Where a direct or an indirect financial interest in the audited entity or its affiliates is held in a trustee capacity by a person in a position to influence the conduct and outcome of the audit, or an immediate family member of such a person, a self-interest threat may be created because either the existence of the trustee interest may influence the conduct of the audit or the trust may influence the actions of the audited entity. Accordingly, such a trustee interest is only held when:
- the relevant person is not an identified potential beneficiary of the trust; and

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

- 20 Where it is not clear whether the financial interest held by the trust in the audited entity is material to the trust or whether the trust is able to exercise significant influence over the audited entity, the financial interest is reported to the Ethics Partner, so that a decision can be made as to the steps that need to be taken.
- 21 A direct or an indirect financial interest in the audited entity or its affiliates held in a trustee capacity by the audit firm or by a partner in the audit firm (other than a partner in a position to influence the conduct and outcome of the audit), or an immediate family member of such a person, can only be held when the relevant person is not an identified potential beneficiary of the trust.

### **Financial interests held by audit firm pension schemes**

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

## **Loans and guarantees**

- 23 Where audit firms, persons in a position to influence the conduct and outcome of the audit or immediate family members of such persons:
- (a) accept a loan<sup>1</sup> or a guarantee of their borrowings from an audited entity; or
  - (b) make a loan to or guarantee the borrowings of an audited entity, a self-interest threat and an intimidation threat to the auditor's objectivity can be created or there may be a perceived loss of independence. In a number of situations, no safeguards can eliminate this threat or reduce it to an acceptable level.
- 24 **Audit firms, persons in a position to influence the conduct and outcome of the audit and immediate family members of such persons shall not make a loan to, or guarantee the borrowings of, an audited entity or its affiliates unless this represents a deposit made with a bank or similar deposit taking institution in the ordinary course of business and on normal business terms.**
- 25 **Audit firms shall not accept a loan from, or have their borrowings guaranteed by, the audited entity or its affiliates unless:**
- (a) the audited 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 audit firm and the audited entity.**
- 26 **Persons in a position to influence the conduct and outcome of the audit and immediate family members of such persons shall not**

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<sup>1</sup> For the purpose of this 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 29).

**accept a loan from, or have their borrowings guaranteed by, the audited entity or its affiliates unless:**

- (a) the audited 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 audited entity.**

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

## **BUSINESS RELATIONSHIPS**

28 A business relationship between:

- (a) the audit firm or a person who is in a position to influence the conduct and outcome of the audit, or an immediate family member of such a person; and
- (b) the audited entity or its affiliates, or its management;

involves the two parties having a common commercial interest. Business relationships may create self-interest, advocacy or intimidation threats to

the auditor's objectivity and perceived loss of independence. Examples include:

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

**29 Audit firms, persons in a position to influence the conduct and outcome of the audit and immediate family members of such persons shall not enter into business relationships with an audited entity, its management or its affiliates except where they:**

- **involve the purchase of goods and services from the audit firm or the audited entity in the ordinary course of business and on an arm's length basis and which are not material to either party; or**
- **are clearly inconsequential to either party.**

**30** Where a business relationship exists, that is not permitted under paragraph 29, and has been entered into by:

- (a) *the audit firm*: either the relationship is terminated or the firm does not accept (or withdraws from) the audit engagement;
- (b) *a person in a position to influence the conduct and outcome of the audit*: either the relationship is terminated or that person does not retain a position in which they exert such influence on the audit engagement;

(c) *an immediate family member of a person in a position to influence the conduct and outcome of the audit*: either the relationship is terminated or the person in a position to influence the conduct and outcome of the audit does not retain such a position.

Where there is an unavoidable delay in the termination of a business relationship, the audit firm adopts safeguards to preserve its objectivity until the relationship is terminated. These may include a review of the relevant person's audit work or a temporary exclusion of the relevant person from influence on conduct and outcome of the audit.

- 31 Compliance with paragraph 29 is not intended to prevent an audit firm giving advice in accordance with regulatory requirements<sup>2</sup> to a third party in relation to investment products or services, including those supplied by an audited entity. In such circumstances, the audit 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 audited entity to the audit firm and assesses whether any safeguards are required.
- 32 **Where a person in a position to influence the conduct and outcome of the audit becomes aware that a close family member has entered into one of the business relationships specified in paragraph 28, that individual shall report the matter to the audit engagement partner to take appropriate action. If it is a close family member of the audit engagement partner or if the audit engagement partner is in doubt as to the action to be taken, the audit engagement partner shall resolve the matter through consultation with the Ethics Partner.**
- 33 Where there are doubts as to whether a transaction or series of transactions are either in the ordinary course of business and on an

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<sup>2</sup> Firms providing such services will be authorised either by the Financial Services Authority or by their professional accountancy body acting as a Designated Professional Body.

arm's length basis or of such materiality that they constitute a threat to the audit firm's objectivity and independence, the audit engagement partner reports the issue:

- to the Ethics Partner, so that a decision can be made as to the appropriate action that needs to be taken to ensure that the matter is resolved; and
- to those charged with governance of the audited entity, together with other significant facts and matters that bear upon the auditor's objectivity and independence, to obtain their views on the matter.

34 Where there are doubts about whether a reasonable and informed third party would conclude that a business relationship is clearly inconsequential to either party and would not therefore present a threat to independence, then it is not clearly inconsequential.

**35 An audit firm shall not provide audit services to any entity or person able to influence the affairs of the audit firm or the performance of any audit engagement undertaken by the audit firm.**

36 This prohibition applies to:

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

A significant ownership is one that carries the ability to influence materially the policy of an entity.<sup>3</sup>

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<sup>3</sup> For companies, competition authorities have generally treated a 15% shareholding as sufficient to provide a material ability to influence policy.

## **EMPLOYMENT RELATIONSHIPS**

### ***MANAGEMENT ROLE WITH AN AUDITED ENTITY***

- 37 **An audit firm shall not admit to the partnership, or employ a person to undertake audit work, if that person is also employed by the audited entity or its affiliates ('dual employment').**

#### **Loan staff assignments**

- 38 **An audit firm shall not enter into an agreement with an audited entity to provide a partner or employee to work for a temporary period as if that individual were an employee of the audited entity or its affiliates (a 'loan staff assignment') unless:**
- (a) the agreement is for a short period of time and does not involve staff or partners performing non-audit services that would not be permitted under APB Ethical Standard 5; and**
  - (b) the audited entity agrees that the individual concerned will not hold a management position, and 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 audited entity to a particular position or accounting treatment.**

- 39 **Where an audit firm agrees to assist an audited entity 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. Thus, for example, interim management arrangements involving participation in the financial reporting function are not acceptable.**

- 40 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 audited entity's financial statements 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.
- 41 **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 the audit involving any function or activity that he or she performed or supervised during that assignment.**
- 42 In considering for how long this restriction is to be observed, the need to realise the potential value to the effectiveness of the audit of the increased knowledge of the audited entity's business gained through the assignment has to be weighed against the potential threats to objectivity and independence. Those threats increase with the length of the assignment and with the intended level of responsibility of the individual within the engagement team. As a minimum, this restriction will apply to at least the first audit of the financial statements following the completion of the loan staff assignment.

### **Partners and engagement team members joining an audited entity**

- 43 **Where a former partner in the audit firm joins the audited entity, the audit firm shall take action as quickly as possible - and, in any event, before any further work is done by the audit firm in connection with the audit - to ensure that no significant connections remain between the firm and the individual.**
- 44 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 audit firm's business or professional activities.

**45 Audit firms shall establish policies and procedures that require:**

- (a) all partners in the audit firm to notify the firm of any situation involving their potential employment with any entity audited by the firm; and**
- (b) senior members of any engagement team to notify the audit firm of any situation involving their potential employment with the relevant audited entity; and**
- (c) other members of any engagement team to notify the audit firm of any situation involving their probable employment with the relevant audited entity; and**
- (d) anyone who has given such notice to be removed from the engagement team; and**
- (e) a review of the audit work performed by the resigning or former engagement team member in the current and, where appropriate, the most recent audit.**

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

47 Where a partner in the audit firm or a member of the engagement team for a particular audited entity has left the audit firm and taken up employment with that 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 audited 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 audit firm.

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

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

49 **Where a partner leaves the firm and is appointed as a director (including as a non-executive director) or to a key management position with an audited entity<sup>4</sup>, having acted as audit engagement partner (or as an engagement quality control reviewer, key partner**

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<sup>4</sup> UK legislation provides that each of the Recognised Supervisory Bodies must have adequate rules and practices to ensure that a key audit partner (the individual responsible for the statutory audit and individuals responsible for a parent undertaking or a material subsidiary undertaking) of a firm appointed by a public interest entity as auditor is prohibited from being appointed as a director or other officer of the entity during a period of two years commencing on the date on which his or her work as key audit partner ended.

**involved in the audit or a partner in the chain of command) at any time in the two years prior to this appointment, the firm shall resign as auditor.<sup>5</sup> The firm shall not accept re-appointment as auditor until a two-year period, commencing when the former partner ceased to have an ability to influence the conduct and outcome of the audit, has elapsed or the former partner ceases employment with the former audited entity, whichever is the sooner.**

**50 Where a former member of the engagement team (other than an audit engagement partner, a key partner involved in the audit or a partner in the chain of command) leaves the audit firm and, within two years of ceasing to hold that position, joins the audited entity as a director (including as a non-executive director) or in a key management position, the audit firm shall consider whether the composition of the audit team is appropriate.**

51 In such circumstances, the audit firm evaluates the appropriateness of the composition of the audit team by reference to the factors listed in paragraph 47 and alters or strengthens the audit team to address any threat to the auditor's objectivity and independence that may be identified.

### **Family members employed by an audited entity**

**52 Where a person in a position to influence the conduct and outcome of the audit, or a partner in the audit firm, becomes aware that an immediate or close family member is employed by an audited entity in a position to exercise influence on the accounting records or financial statements, that individual shall either:**

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<sup>5</sup> The timing of the audit firm's resignation as auditor is determined in accordance with paragraph 50 of APB Ethical Standard 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.

- (a) in the case of an immediate family member of a person in a position to influence the conduct and outcome of the audit, cease to hold a position in which they exert such influence on the audit; or**
- (b) in the case of a close family member of a person in a position to influence the conduct and outcome of the audit, or any family member of a partner in the audit firm, report the matter to the audit engagement partner to take appropriate action. If it is a close family member of the audit engagement partner or if the audit engagement partner is in doubt as to the action to be taken, the audit engagement partner shall resolve the matter in consultation with the Ethics Partner.**

### ***GOVERNANCE ROLE WITH AN AUDITED ENTITY***

- 53 Paragraphs 54 to 56 are supplementary to certain statutory or regulatory provisions that prohibit directors of entities from being appointed as their auditor.<sup>6</sup>
- 54 **The audit firm or a partner or employee of the audit firm shall not accept appointment or perform a role:**
- (a) as an officer<sup>7</sup> or member of the board of directors of the audited entity;**
  - (b) as a member of any subcommittee of that board; or**

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<sup>6</sup> 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.’

<sup>7</sup> As defined in Section 1173 of the Companies Act 2006 as including a director, manager or secretary.

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

**55 Where a person in a position to influence the conduct and outcome of the audit becomes aware that an immediate or close family member holds a position described in paragraph 54, the audit firm shall take appropriate steps to ensure that the relevant person does not retain a position in which they exert influence on the conduct and outcome of the audit engagement.**

**56 Where a partner or employee of the audit firm, not being a member of the engagement team, becomes aware that an immediate or close family member holds a position described in paragraph 54, that individual shall report that fact to the audit engagement partner, who shall consider whether the relationship might be regarded by a reasonable and informed third party as impairing, or being thought to impair, the auditor's objectivity. If the audit engagement partner concludes that the auditor's objectivity may be impaired, that individual shall consult with the Ethics Partner to determine whether appropriate safeguards exist. If no such safeguards exist, the audit firm withdraws from the audit engagement.**

### ***EMPLOYMENT WITH AUDIT FIRM***

**57 Objectivity and independence may be threatened where a former director or employee of the audited entity becomes a member of the engagement team. Self-interest, self-review and familiarity threats may be created where a member of the engagement team has to report on, for example, financial statements which he or she prepared, or elements of the**

financial statements for which he or she had responsibility, while with the audited entity.

**58 Where a former director or a former employee of an audited entity, who was in a position to exert significant influence over the preparation of the financial statements, joins the audit firm, that individual shall not be assigned to a position in which he or she is able to influence the conduct and outcome of the audit for that entity or its affiliates for a period of two years following the date of leaving the audited entity.**

59 In certain circumstances, a longer period of exclusion from the engagement team may be appropriate. For example, threats to objectivity and independence may exist in relation to the audit of the financial statements of any period which are materially affected by the work of that person whilst occupying his or her former position of influence with the audited entity. The significance of these threats depends on factors such as:

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

## **FAMILY AND OTHER PERSONAL RELATIONSHIPS**

60 A relationship between a person who is in a position to influence the conduct and outcome of the audit and another party does not generally affect the consideration of the auditor's objectivity and independence. However, if it is a family relationship, and if the family member also has a financial, business or employment relationship with the audited entity, then self-interest, familiarity or intimidation threats to the auditor's

objectivity and independence may be created. The significance of any such threats depends on such factors as:

- the relevant person's involvement in the audit;
- the nature of the relationship between the relevant person and his or her family member;
- the family member's relationship with the audited entity.

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

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

63 **The audit firm shall establish policies and procedures that require:**  
**(a) partners and professional staff to report to the audit firm any immediate family, close family and other personal relationships involving an entity audited by the firm, to which they are a party and which they consider might create a threat to the auditor's objectivity or a perceived loss of independence;**

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

64 **The audit engagement partner shall:**

**(a) assess the threats to the auditor's objectivity and independence arising from immediate family, close family and other personal relationships on the basis of the information reported to the firm by persons in a position to influence the conduct and outcome of the audit;**

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

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

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

## **EXTERNAL CONSULTANTS INVOLVED IN THE AUDIT**

66 Audit firms may employ external consultants as experts in order to obtain sufficient appropriate audit evidence regarding certain financial statement assertions.<sup>8</sup> There is a risk that an expert's objectivity and independence will be impaired if the expert is related to the entity, for example by being financially dependent upon or having an investment in, the entity.

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<sup>8</sup> ISA (UK and Ireland) 620 *'Using the Work of an Auditor's Expert'* requires that the auditor shall evaluate whether the expert has the necessary objectivity.

- 67 **The audit engagement partner shall be satisfied that any external consultant involved in the audit will be objective and document the rationale for that conclusion.**
- 68 The audit engagement partner obtains information from the external consultant as to the existence of any connections that they have with the audited entity including:
- financial interests;
  - business relationships;
  - employment (past, present and future);
  - family and other personal relationships.

## **EFFECTIVE DATE**

- 69 This revised Ethical Standard becomes effective on 30 April 2011.
- 70 Firms may complete audit engagements relating to periods commencing prior to 31 December 2010 in accordance with existing ethical standards, putting in place any necessary changes in the subsequent engagement period.
- 71 On appointment as auditor to an entity, an audit firm may continue in a business relationship or a loan staff arrangement which is already contracted at the date of appointment, until the earlier of either:
- (i) the completion of the specific obligations under the contract or the end of the contract term, where this is set out in the contract; or
  - (ii) one year after the date of appointment, where obligations or a term are not defined,
- provided that the need for additional safeguards is assessed and if considered necessary, those additional safeguards are applied.