

APB ETHICAL STANDARD 5 (REVISED)

NON-AUDIT SERVICES PROVIDED TO AUDITED ENTITIES

(Revised December 2010, updated December 2011)

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PREFACE

APB Ethical Standards apply in the audit of financial statements. They are read in the context of the Auditing Practices Board's Statement "The Auditing Practices Board – Scope and Authority of Pronouncements (Revised)" which sets out the application and authority of APB Ethical Standards.

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

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

INTRODUCTION

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

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

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

- 2 This Standard provides requirements and guidance on specific circumstances arising from the provision of non-audit services by audit firms to entities audited by them 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 non-audit service engagement in question is not undertaken 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, assess the implications of the breach, determine whether there are safeguards that can be put in place or other actions that can be taken to address any potential adverse

consequences and consider 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 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, by having another partner review the work done by the relevant partner or member of staff or by removing him or her from the engagement team); and
 - (d) the actions taken and the rationale for them are documented.

GENERAL APPROACH TO NON-AUDIT SERVICES

- 5 Paragraphs 6 to 53 of this Standard set out the general approach to be adopted by audit firms and auditors in relation to the provision of non-audit services to entities audited by them. This approach is applicable irrespective of the nature of the non-audit services, which may be in question in a given case. (Paragraphs 54 to 168 of this Standard illustrate the application of the general approach to a number of common non-audit services.)
- 6 An audit is the term used to describe the work that is undertaken by the auditor to enable him or her to express an independent audit opinion on an entity's financial statements and, where the entity is a parent

company, on the group financial statements and/or the separate financial statements of its components¹.

7 International Standards on Auditing (UK and Ireland) require that the auditor exercise professional judgment and maintain professional scepticism throughout the planning and performance of the audit and, among other things:

- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
- Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained².

8 Judgments regarding the nature and extent of evidence necessary to support the audit opinion are a matter for the auditor but will include:

- Identifying, evaluating and testing, where appropriate, those internal control systems the effectiveness of which is necessary for the audit of the financial statements and where, if any control weaknesses are identified, extended testing will be required; and
- additional work undertaken to respond to risks identified by management or the audit committee that the auditor considers could impact the auditor's opinion on the financial statements.

¹ In the public sector the statutory scope of an audit can extend beyond expressing an independent opinion on an entity's financial statements to include reporting on an entity's arrangements to ensure the proper conduct of its financial affairs, manage its performance or use of its resources.

² ISA (UK and Ireland) 200 'Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK and Ireland)' paragraph 7.

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

- The objective of that work is not to gather evidence to support the auditor's opinion on the financial statements; or
- The nature and extent of testing is not determined by the external auditor, or in the case of a group, the component auditors, in the context of expressing an opinion on the financial statements; or
- The principal terms and conditions differ from that of the audit.

10 If additional work on financial information³ and/or financial controls is authorised by those charged with governance, but the objective of that work is not to enable the auditor to provide an audit opinion on the entity's financial statements, it will be considered as an 'audit related service' for the purpose of this Standard provided that it:

- is integrated with the work performed in the audit and performed largely by the existing audit team; and
- is performed on the same principal terms and conditions as the audit.

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

11 Other additional work that:

- does not relate to financial information and/or financial controls; or
- is not integrated with the work performed in the audit, or is not performed largely by the existing audit team, or
- is not on the same principal terms and conditions as the audit;

³ This does not include accounting services.

will be regarded as an 'other non-audit service' for the purpose of this Standard.

- 12 'Non-audit services' comprise any engagement in which an audit firm provides professional services to:
- an audited entity;,
 - an audited entity's affiliates; or
 - another entity in respect of the audited entity⁴;
- other than the audit of financial statements of the audited entity.
- 13 There may be circumstances where the audit firm is engaged to provide a non-audit service and where that engagement and its scope are determined by an entity which is not audited by the firm. However, it might be contemplated that an audited entity may gain some benefit from that engagement⁵. In these circumstances, whilst there may be no threat to the audit firm's objectivity and independence at the time of appointment, the audit firm considers how the engagement may be expected to develop, whether there are any threats that the audit firm may be subject to if additional relevant parties which are audited entities are identified, and whether any safeguards need to be put in place.
- 14 **The audit firm shall establish policies and procedures that require others within the firm, when considering whether to accept a proposed engagement to provide a non-audit service to an audited entity or any of its affiliates, to communicate details of the proposed engagement to the audit engagement partner.**

⁴ For example, where an engagement is undertaken to assist in the preparation of listing particulars for a company acquiring the audited entity

⁵ For example, in a vendor due diligence engagement, the engagement is initiated and scoped by the vendor before the purchaser is identified. If an entity audited by the firm undertaking the due diligence engagement is the purchaser, that audited entity may gain the benefit of the report issued by its auditor, it may be a party to the engagement letter and it may pay an element of the fee.

- 15 The audit firm establishes appropriate channels of internal communication to ensure that, in relation to an entity audited by the firm, the audit engagement partner (or their delegate) is informed about any proposed engagement to provide a non-audit service to the audited entity or any of its affiliates and that he or she considers the implications for the auditor's objectivity and independence before the engagement is accepted. Additionally, when addressing services provided to another entity in respect of the audited entity, the procedures address any requirement to preserve client confidentiality.
- 16 In the case of a listed company, the group audit engagement partner establishes that the company has communicated its policy on the engagement of the external auditor to supply non-audit services to its affiliates and obtains confirmation that the auditors of the affiliates will comply with this policy.⁶ The group audit engagement partner also requires that relevant information on non-audit services provided by network firms is communicated on a timely basis.

IDENTIFICATION AND ASSESSMENT OF THREATS AND SAFEGUARDS

- 17 **Before the audit firm accepts a proposed engagement to provide a non-audit service, the audit engagement partner shall:**
- (a) consider whether it is probable that a reasonable and informed third party would regard the objectives of the proposed engagement as being inconsistent with the objectives of the audit of the financial statements; and**
 - (b) identify and assess the significance of any related threats to the auditor's objectivity, including any perceived loss of independence; and**

⁶ 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.

(c) identify and assess the effectiveness of the available safeguards to eliminate the threats or reduce them to an acceptable level.

18 When assessing the significance of threats to the auditor's objectivity and independence, the audit engagement partner considers the following factors:

- The likely relevance and impact of the subject matter on the financial statements;
- The extent to which performance of the proposed engagement will involve the exercise of professional judgment;
- The size of the engagement and the associated fee;
- The basis on which the fee is to be calculated;
- The staff who would be carrying out the non-audit service⁷;
- The staff from the audited entity who would be involved in the non-audit service⁸.

To ensure that this assessment is made with a proper understanding of the nature of the engagement, it may be necessary to refer to a draft engagement letter in respect of the proposed non-audit services or to discuss the engagement with the partner involved.

19 The assessment of the threats to the auditor's objectivity and independence arising from any particular non-audit engagement is a matter for the audit engagement partner. The audit engagement partner may decide to delegate some information gathering activities to senior personnel on the audit team and may allow such personnel to make

⁷ For example, where those handling the non-audit service engagement are particularly expert so that the audit team (or persons advising it) may have difficulty in reviewing effectively the advice given or the work undertaken by the non-audit service team in the course of conducting a subsequent audit, with the result that the effectiveness of the audit might be compromised.

⁸ For example, the safeguards necessary to address any self-review threat will require careful consideration where those involved are particularly senior and can be expected to be actively involved in any audit discussion as this may also create an intimidation threat.

decisions in relation to routine non-audit services. If this is the case, the audit engagement partner will:

- provide specific criteria for such decisions that reflect both the requirements of APB Ethical Standards and the audited entity's policy for the purchase of non-audit services; and
- monitor the decisions being made on a regular basis.

- 20 Where the audit engagement partner is not able to undertake the assessment of the significance of threats in relation to a proposed engagement to provide a non-audit service to an audited entity, for example due to illness or holidays, alternative arrangements are established (for example, by authorising the engagement quality control reviewer to consider the proposed engagement).
- 21 The objective of the audit of financial statements is to express an opinion on the preparation and presentation of those financial statements. For example, in the case of a limited company, legislation requires the auditor to make a report to the members on all annual accounts laid before the company in general meeting during its tenure of office. The report must include a statement as to whether, in the auditor's opinion, the accounts have been properly prepared in accordance with the requirements of the legislation, and, in particular, whether they give a true and fair view of the state of the affairs and profit or loss for the year
- 22 **Where the audit engagement partner considers that it is probable that a reasonable and informed third party would regard the objectives of the proposed non-audit service engagement as being inconsistent with the objectives of the audit of the financial statements, the audit firm shall either:**
- (a) not undertake the non-audit service engagement; or**
 - (b) not accept or withdraw from the audit engagement.**
- 23 The objectives of engagements to provide non-audit services vary and depend on the specific terms of the engagement. In some cases these

objectives may be inconsistent with those of the audit, and, in such cases, this may give rise to a threat to the auditor's objectivity and to the appearance of its independence. Audit firms do not undertake non-audit service engagements where the objectives of such engagements are inconsistent with the objectives of the audit, or they do not accept or withdraw from the audit engagement as appropriate.

- 24 Similarly, in relation to a possible appointment as auditor to an entity that the audit firm has not audited before, consideration needs to be given to recent, current and potential engagements to provide non-audit services by the audit firm and whether the scope and objectives of those engagements are consistent with the proposed audit engagement. In the case of listed companies, when tendering for a new audit engagement, the audit firm ensures that relevant information on recent non-audit services is drawn to the attention of the audit committee, including:
- when recent non-audit services were provided;
 - the materiality of those non-audit services to the proposed audit engagement;
 - whether those non-audit services would have been prohibited if the entity had been an audited entity at the time when they were undertaken; and
 - the extent to which the outcomes of non-audit services have been audited or reviewed by another audit firm.

Threats to objectivity and independence

- 25 The principal types of threats to the auditor's objectivity and independence are:
- self-interest threat;
 - self-review threat;
 - management threat;
 - advocacy threat;
 - familiarity (or trust) threat; and
 - intimidation threat.

The auditor remains alert to the possibility that any of these threats may occur in connection with non-audit services. However, the threats most commonly associated with non-audit services are self-interest threat, self-review threat, management threat and advocacy threat.

- 26 A **self-interest threat** exists 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. In relation to non-audit services, the main self-interest threat concerns fees and economic dependence and these are addressed in APB Ethical Standard 4.
- 27 Where substantial fees are regularly generated from the provision of non-audit services and the fees for non-audit services are greater than the annual audit fees, the audit engagement partner has regard to the possibility that there may be perceived to be a loss of independence resulting from the expected or actual level of fees for non-audit services. The audit engagement partner determines whether there is any risk that there will be an actual loss of independence and objectivity by the engagement team. In making that assessment, the audit engagement partner considers matters such as whether the engagement or engagements giving rise to the fees for non-audit services were:
- audit related services;
 - provided on a contingent fee basis;
 - consistent with the engagements undertaken and fees received on a consistent basis in previous years;
 - in the case of a group, disproportionate in relation to any individual group entity;
 - unusual in size but unlikely to recur; and/or
 - of such a size and nature that a reasonable and informed third party would be concerned at the effect that such engagements would have on the objectivity and independence of the engagement team.

Having made that assessment, the audit engagement partner determines whether the threats to independence from the level of fees for non-audit services are at an acceptable level (or can be reduced to an acceptable level by putting in place appropriate safeguards) and appropriately informs those charged with governance of the position on a timely basis in accordance with paragraphs 48 to 50 of this Standard.

- 28 **In the case of listed companies where the fees for non-audit services for a financial year are expected to be greater than the annual audit fees, the audit engagement partner shall provide details of the circumstances to the Ethics Partner and discuss them with him or her. Where the audit firm provides audit services to a group, the obligation to provide information to the Ethics Partner shall be on a group basis for all services provided by the audit firm and its network firms to all entities in the group.**
- 29 Discussing the level of fees for non-audit services with the Ethics Partner ensures that appropriate attention is paid to the issue by the audit firm. The audit firm's policies and procedures will set out whether there are circumstances in which the audit engagement partner discusses the level of non-audit fees with the Ethics Partner for non-listed audited entities as described in paragraph 47 of APB Ethical Standard 1.
- 30 Where fees for non-audit services are calculated on a contingent fee basis, there is a risk that a reasonable and informed third party may regard the audit firm's interests to be so closely aligned with the audited entity that it threatens the auditor's objectivity and independence. Consequently, the audit firm does not accept a non-audit services engagement on a contingent fee basis where:
- (a) that contingent fee is material to the audit firm, or that part of the firm by reference to which the audit engagement partner's profit share is calculated; or

- (b) the outcome of the service (and, therefore, the amount of the fee) is dependent on a future or contemporary audit judgment relating to a material matter in the financial statements of an audited entity.
- 31 A **self-review threat** exists when the results of a non-audit service performed by the engagement team or by others within the audit firm are reflected in the amounts included or disclosed in the financial statements.
- 32 A threat to objectivity and independence arises because, 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, it may be (or may appear to be) unable to take an impartial view of relevant aspects of those financial statements.
- 33 In assessing the significance of the self-review threat, the auditor considers the extent to which the non-audit service will:
- involve a significant degree of subjective judgment; and
 - have a material effect on the preparation and presentation of the financial statements.
- 34 Where a significant degree of judgment relating to the financial statements is involved in a non-audit service engagement, the auditor may be inhibited from questioning that judgment in the course of the audit. Whether a significant degree of subjective judgment is involved will depend upon whether the non-audit service involves the application of well-established principles and procedures, and whether reliable information is available. If such circumstances do not exist because the non-audit service is based on concepts, methodologies or assumptions that require judgment and are not established by the audited entity or by authoritative guidance, the auditor's objectivity and the appearance of its independence may be adversely affected. Where the provision of a

proposed non-audit service would also have a material effect on the financial statements, it is unlikely that any safeguard can eliminate or reduce to an acceptable level the self-review threat.

- 35 A **management threat** exists when the audit firm undertakes work that involves making judgments and taking decisions that are properly the responsibility of management.
- 36 Paragraph 33 of APB Ethical Standard 1 prohibits partners and employees of the audit firm from taking decisions on behalf of the management of the audited entity. A threat to objectivity and independence also arises where 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. The auditor may become closely aligned with the views and interests of management and this may erode the distinction between the audited entity and the audit firm, in turn, impairing or calling into question the auditor's ability to apply a proper degree of professional scepticism in auditing the financial statements. The auditor's objectivity and the appearance of its independence therefore may be, or may be perceived to be, impaired.
- 37 In determining whether a non-audit service does or does not give rise to a management threat, the auditor considers whether there is informed management. Informed management exists when:
- the auditor is satisfied that a member of management (or senior employee of the audited entity) has been designated by the audited entity to receive the results of the non-audit service and has been given the authority to make any judgments and decisions of the type set out in paragraph 34 of APB Ethical Standard 1 that are needed;
 - the auditor concludes that that member of management has the capability to make independent management judgments and decisions on the basis of the information provided; and

- the results of the non-audit service are communicated to the audited entity and, where judgments or decisions are to be made they are supported by an objective analysis of the issues to consider and the audited entity is given the opportunity to decide between reasonable alternatives.
- 38 In the absence of such informed management it is unlikely that any other safeguards can eliminate a management threat or reduce it to an acceptable level.
- 39 An **advocacy threat** exists 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.
- 40 A threat to objectivity and independence arises because, 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. For example, where the audit firm, acting as advocate, has supported a particular contention of management, it may be difficult for the auditor to take an impartial view of this in the context of the audit of the financial statements.
- 41 Where the provision of a non-audit service would require the auditor to act as an advocate for the audited entity in relation to matters that are material to the financial statements, it is unlikely that any safeguards can eliminate or reduce to an acceptable level the advocacy threat that would exist.
- 42 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.

Safeguards

- 43 Where any threat to the auditor's objectivity and the appearance of its independence is identified, the audit engagement partner assesses the significance of that threat and considers whether there are safeguards that could be applied and which would be effective to eliminate the threat or reduce it to an acceptable level. If such safeguards can be identified and are applied, the non-audit service may be provided. However, where no such safeguards are applied, the only course is for the audit firm either not to undertake the engagement to provide the non-audit service in question or not to accept (or to withdraw from) the audit engagement.
- 44 When considering what safeguards, if any, would be effective in reducing the threats to independence and objectivity to an acceptable level, the audit engagement partner has regard to the following safeguards which, individually or in combination, may be effective, depending on the circumstances:
- a. The non-audit services are provided by a separate team from the engagement team, and:
 - if circumstances require, to address the threat identified, there is effective physical and electronic segregation of the individuals in each team, and of their documentation, at all times during the provision of the audit and non-audit services; and/or
 - the team providing the non-audit services avoids taking any action or making any statement that compromises the independence or objectivity of the engagement team, for example, expressing any opinion about the approach that the engagement team might take or the conclusion it might reach

when considering the appropriateness of accounting or other audit judgments.

The Ethics Partner establishes policies and procedures to ensure that, where safeguards of this nature are considered appropriate, the arrangements put in place are effective at all times. This will involve the Ethics Partner being satisfied that there are effective arrangements in place for each member of the non-audit services team to acknowledge their responsibilities and for each member of the engagement team to notify him or her of any breach of this requirement that the team member becomes aware. Where notified of a breach, the Ethics Partner considers together with the audit engagement partner the significance of the breach and the implications for the independence and objectivity of the engagement team, including whether any further safeguards are necessary and whether the matter should be reported to those charged with governance of the audited entity;

- b The Engagement Quality Control Reviewer, or another audit partner of sufficient relevant experience and seniority who is, and is seen to be, an effective challenge to both the audit engagement partner and the partner leading the non-audit services engagement, reviews the work and conclusions of the engagement team in relation to their consideration of the audit judgments, if any, relating to the subject matter of the non-audit service, having regard to the self-review threat identified, and determines and documents his or her conclusions as to whether the work is sufficient and the conclusions of the engagement team are appropriate. Where the review partner has concerns, the audit engagement partner does not sign the audit opinion until those concerns have been subject to full consultation, including escalation through any processes required by the audit firm's policies. Where this safeguard is considered appropriate, the Ethics Partner is satisfied that the review partner undertaking this role is appropriate, that the review partner is aware of the circumstances leading to the conclusion that there is a significant self-review threat and that any concerns raised by the review

partner have been satisfactorily resolved before signature of the audit opinion.

45 Where the audit engagement partner concludes that no appropriate safeguards are available to eliminate or reduce to an acceptable level the threats to the auditor's objectivity, including any perceived loss of independence, related to a proposed engagement to provide a non-audit service to an audited entity, he or she shall inform the others concerned within the audit firm of that conclusion and the firm shall either:

(a) not undertake the non-audit service engagement; or

(b) not accept or withdraw from the audit engagement.

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

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

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

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

- 48 **The audit engagement partner shall ensure that those charged with governance of the audited entity are appropriately informed on a timely basis of:**
- (a) all significant facts and matters that bear upon the auditor’s objectivity and independence, related to the provision of non-audit services, including the safeguards put in place; and**
 - (b) for listed companies, 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.⁶**
- 49 Transparency is a key element in addressing the issues raised by the provision of non-audit services by audit firms to the entities audited by them. This can be facilitated by timely communication with those charged with governance of the audited entity (see APB Ethical Standard 1, paragraphs 63 to 71). Such communications are addressed to the audit committee, where there is one; in other circumstances, they are addressed to the board of directors (or those in an equivalent position). In the case of listed companies, ensuring that the audit committee is properly informed about the issues associated with the provision of non-audit services will assist them to comply with the provisions of the UK Corporate Governance Code relating to reviewing and monitoring the external auditor’s independence and objectivity and to developing a policy on the engagement of the external auditor to supply non-audit services. This will include discussion of any inconsistencies between the company’s policy and APB Ethical Standards and ensuring that the policy is communicated to affiliates.
- 50 Communications with those charged with governance regarding the impact on auditor objectivity of non-audit services are likely to be facilitated if disclosure of such non-audit services distinguishes between

audit related services and other non-audit services (as defined in this Standard).

DOCUMENTATION

- 51 **The audit engagement partner shall ensure that the reasoning for a decision to undertake an engagement to provide non-audit services, and any safeguards adopted, is appropriately documented.**
- 52 Matters to be documented include any significant judgments concerning:
- threats identified;
 - safeguards adopted and the reasons why they are considered to be effective; and
 - communication with those charged with governance.
- 53 In situations where a management threat is identified in connection with the provision of non-audit services, this documentation will include the auditor's assessment of whether there is informed management. The documentation of communications with the audited entity where judgments and decisions are made by management may take a variety of forms, for example an informal meeting note covering the matters discussed.

APPLICATION OF GENERAL PRINCIPLES TO SPECIFIC NON-AUDIT SERVICES

AUDIT RELATED SERVICES

- 54 Audit related services are those non-audit services specified in this Standard that are largely carried out by members of the engagement team and where the work involved is closely related to the work

performed in the audit and the threats to auditor independence are clearly insignificant and, as a consequence, safeguards need not be applied.

55 Audit related services are:

- Reporting required by law or regulation to be provided by the auditor;
- Reviews of interim financial information;
- Reporting on regulatory returns;
- Reporting to a regulator on client assets;
- Reporting on government grants;
- Reporting on internal financial controls when required by law or regulation;
- Extended audit work that is authorised by those charged with governance performed on financial information⁹ and/or financial controls where this work is integrated with the audit work and is performed on the same principal terms and conditions.

56 The audit engagement partner shall ensure that only those non-audit services listed in paragraph 55 are described as audit related services in communications with those charged with governance of the audited entity.

57 There may be other services that the auditor considers are closely related to an audit. However the threats to auditor independence arising from such services are not necessarily clearly insignificant and the auditor considers whether such services give rise to threats to independence and, where appropriate, the need to apply safeguards.

⁹ This does not include accounting services.

INTERNAL AUDIT SERVICES

- 58 The range of 'internal audit services' is wide and they may not be termed as such by the audited entity. For example, the audit firm may be engaged:
- to outsource the audited entity's entire internal audit function; or
 - to supplement the audited entity's internal audit function in specific areas (for example, by providing specialised technical services or resources in particular locations); or
 - to provide occasional internal audit services to the audited entity on an *ad hoc* basis.

All such engagements would fall within the term 'internal audit services'.

- 59 The nature of possible internal audit services is also wide. While the internal audit remit will vary from company to company, it often involves assurance activities designed to assess the design and operating effectiveness of existing or proposed systems or controls and advisory activities where advice is given to an entity on the design and implementation of risk management, control and governance processes.
- 60 The nature and extent of the threats to the external auditor's independence when undertaking internal audit services vary depending on the nature of the services provided. The main threats to the auditor's objectivity and independence arising from the provision of internal audit services are the self-review threat and the management threat. Generally these will be lower for activities that are primarily designed to provide assurance to those charged with governance, for example that internal controls are operating effectively, than for advisory activities designed to assist the entity in improving the effectiveness of its risk management, control and governance processes.
- 61 Engagements to provide internal audit services - other than those prohibited in paragraph 63 - may be undertaken, provided that the

auditor is satisfied that there is informed management and appropriate safeguards are applied to reduce the self-review threat to an acceptable level.

62 Examples of safeguards that may be appropriate when internal audit services are provided to an audited entity include ensuring that:

- internal audit projects undertaken by the audit firm are performed by partners and staff who have no involvement in the external audit of the financial statements;
- the audit of the financial statements is reviewed by an audit partner who is not involved in the audit engagement, to ensure that the internal audit work performed by the audit firm has been properly and effectively assessed in the context of the audit of the financial statements.

63 **The audit firm shall not undertake an engagement to provide internal audit services to an audited entity where it is reasonably foreseeable that:**

- (a) for the purposes of the audit of the financial statements, the auditor would place significant reliance on the internal audit work performed by the audit firm; or**
- (b) for the purposes of the internal audit services, the audit firm would undertake part of the role of management.**

64 The self-review threat is unacceptably high where substantially all of the internal audit activity is outsourced to the audit firm and this is significant to the audited entity or the auditor cannot perform the audit of the financial statements without placing significant reliance on the work performed for the purposes of the internal audit services engagement. In the case of listed companies the provision of internal audit services in relation to the following examples is likely to be unacceptable as the external audit team is likely to place significant reliance on the work

performed by the internal audit team in relation to the audited entity's internal financial controls:

- a significant part of the internal controls over financial reporting;
- financial accounting systems which generate information that is significant to the client's accounting records;
- amounts or disclosures that are material to the financial statements of the audited entity.

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

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

66 During the course of the audit, the auditor generally evaluates the design and tests the operating effectiveness of some of the entity's internal financial controls, and the operation of any relevant internal audit function, and provides management with observations on matters that have come to the attention of the auditor, including comments on weaknesses in the internal control systems and/or the internal audit function together with suggestions for addressing them. This work is a by-product of the audit service rather than the result of a specific engagement to provide non-audit services and therefore does not constitute internal audit services for the purposes of this Standard.

- 67 In some circumstances, additional work is undertaken to respond to risks identified by management or those charged with governance. Where the auditor considers that such risks could impact their opinion on the financial statements, such work is considered to be audit work for the purposes of this Standard (see paragraphs 10 and 11).
- 68 If extended audit work on financial information and/or financial controls is authorised by those charged with governance, it will be considered as an 'audit related service' provided that it is integrated with the work performed in the audit and performed largely by the existing audit team, and is performed on the same principal terms and conditions as the audit.
- 69 Additional work will not be considered an audit related service if it:
- does not relate to financial information and/or financial controls; or
 - is not authorised by those charged with governance; or
 - is not integrated with the work performed in the audit, or is not performed largely by the existing audit team; or
 - is not on the same principal terms and conditions as the audit.

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

INFORMATION TECHNOLOGY SERVICES

- 70 Design, provision and implementation of information technology (including financial information technology) systems by audit firms for entities audited by them creates threats to the auditor's objectivity and independence. The principal threats are the self-review threat and the management threat.
- 71 Engagements to design, provide or implement information technology systems that are not important to any significant part of the accounting system or to the production of the financial statements and do not have significant reliance placed on them by the auditor, may be undertaken, provided that there is informed management and appropriate safeguards are applied to reduce the self-review threat to an acceptable level.
- 72 Examples of safeguards that may be appropriate when information technology services are provided to an audited entity include ensuring that:
- information technology projects undertaken by the audit firm are performed by partners and staff who have no involvement in the external audit of the financial statements;
 - the audit of the financial statements is reviewed by an audit partner who is not involved in the audit engagement to ensure that the information technology work performed has been properly and effectively assessed in the context of the audit of the financial statements.
- 73 **The audit firm shall not undertake an engagement to design, provide or implement information technology systems for an audited entity where:**
- (a) the systems concerned would be important to any significant part of the accounting system or to the production of the financial statements and the auditor would place significant**

reliance upon them as part of the audit of the financial statements; or

(b) for the purposes of the information technology services, the audit firm would undertake part of the role of management.

- 74 Where it is reasonably apparent that, having regard to the activities and size of the audited entity and the range and complexity of the proposed system, management lacks the expertise required to take responsibility for the systems concerned, it is unlikely that any safeguards would be sufficient to eliminate these threats or to reduce them to an acceptable level. In particular, formal acceptance by management of the systems designed and installed by the audit firm is unlikely to be an effective safeguard when, in substance, the audit firm has been retained by management as experts and makes important decisions in relation to the design or implementation of systems of internal control and financial reporting.
- 75 The provision and installation of information technology services associated with a standard 'off the shelf accounting package' (including basic set-up procedures to make the package operate on the audited entity's existing platform and peripherals, setting up the chart of accounts and the entry of standard data such as the audited entity's product names and prices) is unlikely to create a level of threat to the auditor's objectivity and independence that cannot be addressed through applying appropriate safeguards.

VALUATION SERVICES

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

- 77 The audit firm shall not undertake an engagement to provide a valuation to:**
- (a) an audited entity that is a listed company or a significant affiliate of such an entity, where the valuation would have a material effect on the listed company's financial statements, either separately or in aggregate with other valuations provided; or**
 - (b) any other audited entity, where the valuation would both involve a significant degree of subjective judgment and have a material effect on the financial statements either separately or in aggregate with other valuations provided.**
- 78 The main threats to the auditor's objectivity and independence arising from the provision of valuation services are the self-review threat and the management threat. In all cases, the self-review threat is considered too high to allow the provision of valuation services which involve the valuation of amounts with a significant degree of subjectivity and have a material effect on the financial statements.
- 79 For listed companies, or significant affiliates of such entities, the threats to the auditor's objectivity and independence that would be perceived to be created are too high to allow the audit firm to undertake any valuation that has a material effect on the listed company's financial statements.
- 80 The audit firm's policies and procedures will set out whether there are circumstances in which valuation services are not undertaken for non-listed audited entities as described in paragraph 47 of APB Ethical Standard 1.
- 81 In circumstances where the auditor is designated by legislation or regulation as being required to carry out a valuation the restrictions in paragraph 77 do not apply. In such circumstances, the audit engagement partner applies relevant safeguards.

82 It is usual for the auditor to provide management with accounting advice in relation to valuation matters that have come to the auditor's attention during the course of the audit. Such matters might typically include:

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

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

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

ACTUARIAL VALUATION SERVICES

84 **The audit firm shall not undertake an engagement to provide actuarial valuation services to:**

- (a) an audited entity that is a listed company or a significant affiliate of such an entity, unless the firm is satisfied that the valuation has no material effect on the listed company's financial statements, either separately or in aggregate with other valuations provided; or**
- (b) any other audited entity, unless the firm is satisfied that either all significant judgments, including the assumptions, are made by informed management or the valuation has no material effect on the financial statements, either separately or in aggregate with other valuations provided.**

85 Actuarial valuation services are subject to the same general principles as other valuation services. In all cases, where they involve the audit firm in making a subjective judgment and have a material effect on the financial

statements, actuarial valuations give rise to an unacceptable level of self-review threat and so may not be performed by audit firms for entities audited by them.

- 86 In the case of non-listed companies where all significant judgments concerning the assumptions, methodology and data for the actuarial valuation are made by informed management and the audit firm's role is limited to applying proven methodologies using the given data, for which the management takes responsibility, it may be possible to establish effective safeguards to protect the auditors' objectivity and the appearance of its independence.
- 87 For listed companies, or significant affiliates of such entities, the threats to the auditor's objectivity and independence that would be perceived to be created are too high to allow the audit firm to undertake any actuarial valuation unless the firm is satisfied that the valuation has no material effect on the listed company's financial statements.
- 88 The audit firm's policies and procedures will set out whether there are circumstances in which actuarial valuation services are not undertaken for non-listed audited entities as described in paragraph 47 of APB Ethical Standard 1.

TAX SERVICES

89 The range of activities encompassed by the term 'tax services' is wide. Three broad categories of tax service can be distinguished. They are where the audit firm:

- (a) provides advice to the audited entity on one or more specific matters at the request of the audited entity; or
- (b) undertakes a substantial proportion of the tax planning or compliance work for the audited entity; or
- (c) promotes tax structures or products to the audited entity, the effectiveness of which is likely to be influenced by the manner in which they are accounted for in the financial statements.

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

90 The provision of tax services by audit firms to entities audited by them may give rise to a number of threats to the auditor's objectivity and independence, including the self-interest threat, the management threat, the advocacy threat and, where the work involves a significant degree of subjective judgment and has a material effect on the financial statements, the self-review threat.

91 Where the audit firm provides advice to the audited entity on one or more specific matters at the request of the audited entity, a self-review threat may be created. This self-review threat is more significant where the audit firm undertakes a substantial proportion of the tax planning and compliance work for the audited entity. However, the auditor may be able

to undertake such engagements, provided that there is informed management and appropriate safeguards are applied to reduce the self-review threat to an acceptable level.

92 Examples of such safeguards that may be appropriate when tax services are provided to an audited entity include ensuring that:

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

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

94 Where the audit firm promotes tax structures or products or undertakes an engagement to provide tax advice to the audited entity, it may be necessary to adopt an accounting treatment that is not based on well established interpretations or may not be appropriate, in order to achieve the desired result. A self-review threat arises in the course of an audit because the auditor may be unable to form an impartial view of the

accounting treatment to be adopted for the purposes of the proposed arrangements. Accordingly, this Standard does not permit the promotion of tax structures or products by audit firms to entities audited by them where, in the view of the audit engagement partner, after such consultation as is appropriate, there is reasonable doubt as to whether the effectiveness of the tax structure or product depends on an accounting treatment that is well established and appropriate.

- 95 **The audit firm shall not undertake an engagement to provide tax services wholly or partly on a contingent fee basis where the outcome of those tax services (and, therefore, the amount of the fee) is dependent on the proposed application of tax law which is uncertain or has not been established.**
- 96 Where tax services, such as advising on corporate structures and structuring transactions to achieve a particular effect, are undertaken on a contingent fee basis, self-interest threats to the auditor's objectivity and independence may arise. The auditor may have, or may appear to have, an interest in the success of the tax services, causing the audit firm to make an audit judgment about which there is reasonable doubt as to its appropriateness. Where the contingent fee is determined by the outcome of the application of tax law which is uncertain or has not been established, the self-interest threat cannot be eliminated or reduced to an acceptable level by the application of any safeguards.
- 97 **The audit firm shall not undertake an engagement to provide tax services to an audited entity where the engagement would involve the audit firm undertaking a management role.**
- 98 When providing tax services to an audited entity, there is a risk that the audit firm undertakes a management role, unless the firm is working with informed management.

- 99 **Where an audited entity is a listed company or a significant affiliate of such an entity, the audit firm shall not undertake an engagement to prepare current or deferred tax calculations that are or may reasonably be expected to be used when preparing accounting entries that are material to the financial statements of the audited entity, save where the circumstances contemplated in paragraph 164 apply.**
- 100 For listed companies or significant affiliates of such entities, the threats to the auditor's objectivity and independence that would be created are too high to allow the audit firm to undertake an engagement to prepare calculations of current or deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are material to the relevant financial statements, together with associated disclosure notes, save where the circumstances contemplated in paragraph 164 apply.
- 101 Paragraph 99 is not intended to prevent an audit firm preparing tax calculations after the completion of the audit for the purpose of submitting tax returns.
- 102 For entities other than listed companies or significant affiliates of listed companies, the auditor may undertake an engagement to prepare current or deferred tax calculations for the purpose of preparing accounting entries, provided that:
- (a) such services:
 - (i) do not involve initiating transactions or taking management decisions; and
 - (ii) are of a technical, mechanical or an informative nature; and
 - (b) appropriate safeguards are applied.
- 103 The audit firm's policies and procedures will set out whether there are circumstances in which current or deferred tax calculations for the purpose of preparing accounting entries are not prepared for non-listed audited entities as described in paragraph 47 of APB Ethical Standard 1.

- 104 **The audit firm shall not undertake an engagement to provide tax services to an audited entity where this would involve acting as an advocate for the audited entity, before an appeals tribunal or court⁵ in the resolution of an issue:**
- (a) that is material to the financial statements; or**
 - (b) where the outcome of the tax issue is dependent on a future or contemporary audit judgment.**

105 Where the tax services to be provided by the audit firm include representing the audited entity in any negotiations or proceedings involving the tax authorities, advocacy threats to the auditor's objectivity and independence may arise.

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

107 Where the tax authorities indicate that they are minded to reject the audited entity's arguments on a particular issue and the matter is likely to be determined by an appeals tribunal or court, the audit firm may become so closely identified with management's arguments that the auditor is inhibited from forming an impartial view of the treatment of the issue in the financial statements. In such circumstances, if the issue is material to the financial statements or is dependent on a future or contemporary audit judgment, the audit firm discusses the matter with the audited entity and makes it clear that it will have to withdraw from

⁵ The restriction applies to the first level of Tax Court that is independent of the tax authorities and to more authoritative bodies. In the UK this would be the General or Special Commissioners of HM Revenue & Customs or the VAT and Duties Tribunal.

that element of the engagement to provide tax services that requires it to act as advocate for the audited entity, or resign from the audit engagement from the time when the matter is formally listed for hearing before the appeals tribunal.

- 108 The audit firm is not, however, precluded from having a continuing role (for example, responding to specific requests for information) for the audited entity in relation to the appeal. The audit firm assesses the threat associated with any continuing role in accordance with the provisions of paragraphs 109 to 112 of this Standard.

LITIGATION SUPPORT SERVICES

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

- 110 **The audit firm shall not undertake an engagement to provide litigation support services to:**

- (a) an audited entity that is a listed company or a significant affiliate of such an entity, where this would involve the estimation by the audit firm of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the listed company's financial statements, either separately or in aggregate with other estimates and valuations provided; or**
- (b) any other audited entity, where this would involve the estimation by the audit firm of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the financial statements, either separately or in aggregate with other estimates and valuations**

provided and there is a significant degree of subjectivity involved.

111 In the case of non-listed entities, litigation support services that do not involve such subjective estimations are not prohibited, provided that the audit firm has carefully considered the implications of any threats and established appropriate safeguards.

112 The audit firm's policies and procedures will set out whether there are circumstances in which litigation support services are not undertaken for non-listed audited entities as described in paragraph 47 of APB Ethical Standard 1.

LEGAL SERVICES

113 The audit firm shall not undertake an engagement to provide legal services to an audited entity where this would involve acting as the solicitor formally nominated to represent the audited entity in the resolution of a dispute or litigation which is material to the amounts to be included or the disclosures to be made in the financial statements.

114 Although the provision by the auditor of certain types of legal services to its audited entities may create advocacy, self-review and management threats, this Standard does not impose a general prohibition on the provision of legal services. However, in view of the degree of advocacy involved in litigation or other types of dispute resolution procedures and the potential importance of any assessment by the auditor of the merits of the audited entity's position when auditing its financial statements, this Standard prohibits an audit firm from acting as the formally nominated representative for an audited entity in the resolution of a dispute or litigation which is material to the financial statements (either in terms of the amounts recognised or disclosed in the financial statements).

RECRUITMENT AND REMUNERATION SERVICES

- 115 **The audit firm shall not undertake an engagement to provide recruitment services to an audited entity that would involve the firm taking responsibility for the appointment of any director or employee of the audited entity.**
- 116 A management threat arises where audit firm personnel take responsibility for any decision as to who is appointed by the audited entity.
- 117 **For an audited entity that is a listed company, the audit firm shall not undertake an engagement to provide recruitment services in relation to a key management position of the audited entity, or a significant affiliate of such an entity.**
- 118 A familiarity threat arises if the audit firm plays a significant role in relation to the identification and recruitment of senior members of management within the company, as the engagement team may be less likely to be critical of the information or explanations provided by such individuals than might otherwise be the case. Accordingly, for listed companies, and for significant affiliates of such entities, the audit firm does not undertake engagements that involve the recruitment of individuals for key management positions.
- 119 The audit firm's policies and procedures will set out whether there are circumstances in which recruitment services are not undertaken for non-listed audited entities as described in paragraph 47 of APB Ethical Standard 1.
- 120 Recruitment services involve a specifically identifiable, and separately remunerated, engagement. Audit firms and engagement teams may

contribute to an entity's recruitment process in less formal ways. The prohibition set out in paragraph 117 does not extend to:

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

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

122 The provision of advice on remuneration packages (including bonus arrangements, incentive plans and other benefits) to existing or prospective employees of the audited entity gives rise to familiarity threats. The significance of the familiarity threat is considered too high to allow advice on the overall amounts to be paid or on the quantitative measurement criteria included in remuneration packages for directors and key management positions.

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

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

125 Advice on tax, pensions and interpretation of accounting standards relating to remuneration packages for directors and key management can be provided by the audit firm, provided they are not prohibited by the requirements of this Standard relating to tax, actuarial valuations and accounting services. Disclosure of the provision of any such advice would be made to those charged with governance of the audited entity (see APB Ethical Standard 1, paragraphs 63 to 71).

CORPORATE FINANCE SERVICES

126 The range of services encompassed by the term 'corporate finance services' is wide. For example, the audit firm may be engaged:

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

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

- 128 When providing corporate finance services to an audited entity, there is a risk that the audit firm undertakes a management role, unless the firm is working with informed management. Appropriate safeguards are applied to reduce the self-review threat to an acceptable level.
- 129 Examples of safeguards that may be appropriate when corporate finance services are provided to an audited entity include ensuring that:
- the corporate finance advice is provided by partners and staff who have no involvement in the audit of the financial statements;
 - any advice provided is reviewed by an independent corporate finance partner within the audit firm;
 - external independent advice on the corporate finance work is obtained;
 - an audit partner who is not involved in the audit engagement reviews the audit work performed in relation to the subject matter of the corporate finance services provided to ensure that such audit work has been properly and effectively reviewed and assessed in the context of the audit of the financial statements.
- 130 Where the audit firm undertakes an engagement to provide corporate finance services to an audited entity in connection with conducting the sale or purchase of a material part of the audited entity's business, the audit engagement partner informs the audit committee (or equivalent) about the engagement, as set out in paragraphs 63 to 71 of APB Ethical Standard 1.
- 131 **The audit firm shall not undertake an engagement to provide corporate finance services in respect of an audited entity where:**
- (a) the engagement would involve the audit firm taking responsibility for dealing in, underwriting, or promoting shares; or**

(b) the audit engagement partner has, or ought to have, reasonable doubt as to whether an accounting treatment that is subject to a contemporary or future audit judgment relating to a material matter in the financial statements of the audited entity, and upon which the success of the related transaction depends:

(i) is based on well established interpretations; or

(ii) is appropriate,

having regard to the requirement for the financial statements to give a true and fair view in accordance with the relevant financial reporting framework; or

(c) the engagement would involve the audit firm undertaking a management role in the audited entity.

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

133 Where the audit firm acts as a sponsor under the Listing Rules⁶, or as Nominated Adviser on the admission of the audited entity to the AIM, the audit firm is required to confirm that the audited entity has satisfied all applicable conditions for listing and other relevant requirements of the listing (or AIM) rules. Where there is, or there ought to be, reasonable doubt that the audit firm will be able to give that confirmation, it does not enter into such an engagement.

134 A self-review threat arises where the outcome or consequences of the corporate finance service provided by the audit firm may be material to the financial statements of the audited entity, which are, or will be,

⁶ In the United Kingdom, the UK Listing Authority's publication the 'Listing Rules'. In the Republic of Ireland, the United Kingdom 'Listing Rules' as modified by the 'Notes on the Listing Rules' published by the Irish Stock Exchange.

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

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

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

TRANSACTION RELATED SERVICES

137 In addition to corporate finance services, there are other non-audit services associated with transactions that an audit firm may undertake for an audited entity. For example:

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

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

138 When providing transaction related services to an audited entity, there is a risk that the audit firm may face a management threat, unless the firm is working with informed management. Appropriate safeguards are applied to reduce the self-review threat to an acceptable level.

139 Examples of safeguards that may be appropriate when transaction related services are provided to an audited entity include ensuring that:

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

140 **The audit firm shall not undertake an engagement to provide transaction related services in respect of an audited entity where:**

- (a) the audit engagement partner has, or ought to have, reasonable doubt as to whether an accounting treatment that is subject to a contemporary or future audit judgment relating to a material matter in the financial statements of the audited**

entity, and upon which the success of the related transaction depends;

(i) is based on well established interpretations; or

(ii) is appropriate,

having regard to the requirement for the financial statements to give a true and fair view in accordance with the relevant financial reporting framework; or

(b) the engagement would involve the audit firm undertaking a management role in the audited entity.

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

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

RESTRUCTURING SERVICES

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

144 The services that an entity may engage an audit firm to provide may vary considerably and may range from the incidental and routine to advice that is fundamental to the efficacy of the restructuring plan. Consequently, where such services are provided by the entity's auditor, the audit engagement partner evaluates

- the threats that the services may present to the audit firm's ability to conduct any contemporary or future audit with objectivity and independence; and
- the likelihood that a reasonable and informed third party would conclude that the auditor's objectivity and independence would be compromised.

145 **The audit firm shall not undertake an engagement to provide restructuring services in respect of an audited entity where:**

- (a) the engagement would involve the audit firm undertaking a management role in or on behalf of the audited entity; or**
- (b) the engagement would require the audit firm to act as an**

advocate for the audited entity in relation to matters that are material to the financial statements.

146 The potential for the auditor's objectivity and independence to be impaired through the provision of restructuring services varies depending on the nature of the service provided. Two of the main threats to auditor objectivity and independence arising from the provision of restructuring services arise where the auditor undertakes a management or advocacy role:

- An audit firm undertakes a management role if the entity does not have informed management capable of taking responsibility for the decisions to be made.
- To avoid undertaking an advocacy role on behalf of the audited entity, the audit firm takes particular care not to assume (or seen to be assuming) responsibility for the entity's proposals or being regarded as negotiating on behalf of the entity or advocating the appropriateness of the proposals such that its independence is compromised. This is particularly important when the auditor attends meetings with the entity's bank or other interested parties.

If the audit firm undertakes a management role or acts as advocate for the audited entity, the threats to that auditor's objectivity and independence are such that no safeguards can reduce the threat to an acceptable level¹⁰.

147 The audit firm shall not undertake an engagement to provide restructuring services in respect of an audited entity where that engagement may give rise to a self review threat in the course of a contemporary or future audit unless it is satisfied that such threats can be reduced to an acceptable level by appropriate safeguards and that such safeguards have been put in place.

¹⁰ 'ES – Provisions Available for Small Entities (Revised)' provides exemptions relating to informed management and the advocacy threat for auditors of small entities.

- 148 The provision of restructuring services gives rise to a self review threat where the restructuring services to be provided involve advice or judgments which are likely to be material to a contemporary or future audit judgment.
- 149 Examples of restructuring services that the audit firm may be requested to undertake and which may give rise to a self review threat include:
- Providing preliminary general advice on the options and choices available to management or stakeholders of an entity facing urgent financial or other difficulties.
 - Undertaking a review of the business of the entity with a view to advising the audited entity on liquidity management or operational restructuring options.
 - Advising on the development of forecasts or projections, for presentation to lenders and other stakeholders, including assumptions.
 - Advising the audited entity on how to fund its financing requirements, including equity and debt restructuring programmes.
 - Participating in the design or implementation of an overall restructuring plan including, for example, participating in the preparation of cash flow and other forecasts and financial models underpinning the overall restructuring plan.
- 150 The self review threat arising from the provision of such services is particularly significant where it has potential to impact the auditor's assessment of whether it is appropriate to prepare the entity's financial statements on a going concern basis. Where the audit firm has been involved in aspects of the preparation of a cash flow, a forecast or a financial model, it is probable that a reasonable and informed third party would conclude that the auditor would have a significant self-review threat in considering the going concern assumption.

- 151 The self review threat arising from the provision of such services is also particularly significant where the restructuring services are provided in respect of an audited entity and involve developing or implementing a restructuring plan to address the actual or anticipated financial or operational difficulties that threaten the survival of that entity as a going concern (an 'audited entity in distress').
- 152 The audit firm puts in place those safeguards that it regards as appropriate to reduce the threats to its objectivity and independence to an acceptable level. If the audit firm concludes that the threats arising from some or all of the restructuring services involved cannot be addressed by putting appropriate safeguards in place, it declines the engagement, or those parts of the engagement affected by those threats that cannot be addressed.
- 153 **Where an audited entity in distress is a listed company or a significant affiliate of a listed audited entity, the restructuring services provided by the audit firm shall be limited to providing:**
- (a) preliminary general advice to an entity in distress;**
 - (b) assistance with the implementation of elements of an overall restructuring plan, such as the sale of a non-significant component business, provided those elements are not material to the overall restructuring plan;**
 - (c) challenging, but in no circumstances developing, the projections and assumptions within a financial model that has been produced by the audited entity;**
 - (d) reporting on a restructuring plan, or aspects of it, in connection with the proposed issue of an investment circular; and**
 - (e) where specifically permitted by a regulatory body with oversight of the audited entity.**
- 154 Except to the extent identified in paragraph 153, the significance of the self-review threat is too high to permit the provision of other restructuring

services to an audited entity in distress that is a listed company or a significant affiliate of a listed audited entity because there are no safeguards that would be sufficient to reduce the resultant threats to an acceptable level.

- 155 The audit firm's policies and procedures will set out whether there are circumstances in which restructuring services are not undertaken for non-listed audited entities in distress as described in paragraph 47 of APB Ethical Standard 1.

ACCOUNTING SERVICES

- 156 In this Standard, the term 'accounting services' is defined as the provision of services that involve the maintenance of accounting records or the preparation of financial statements that are then subject to audit. Advice on the implementation of current and proposed accounting standards is not included in the term 'accounting services'.

- 157 The range of activities encompassed by the term 'accounting services' is wide. In some cases, the audited entity may ask the audit firm to provide a complete service including maintaining all of the accounting records and the preparation of the financial statements. Other common situations are:

- the audit firm may take over the provision of a specific accounting function on an outsourced basis (for example, payroll);
- the audited entity maintains the accounting records, undertakes basic bookkeeping and prepares a year-end trial balance and asks the audit firm to assist with the preparation of the necessary adjustments and the financial statements.

- 158 The provision of accounting services by the audit firm to the audited entity creates threats to the auditor's objectivity and independence, principally self-review and management threats, the significance of which

depends on the nature and extent of the accounting services in question and upon the level of public interest in the audited entity.

159 When providing accounting services to an audited entity, unless the firm is working with informed management, there is a risk that the audit firm undertakes a management role.

160 **The audit firm shall not undertake an engagement to provide accounting services to:**

- (a) an audited entity that is a listed company or a significant affiliate of such an entity, save where the circumstances contemplated in paragraph 164 apply; or**
- (b) any other audited entity, where those accounting services would involve the audit firm undertaking part of the role of management.**

161 Even where there is no engagement to provide any accounting services, it is usual for the auditor to provide the management with accounting advice on matters that have come to the auditor's attention during the course of the audit. Such matters might typically include:

- comments on weaknesses in the accounting records and suggestions for addressing them;
- errors identified in the accounting records and in the financial statements and suggestions for correcting them;
- advice on the accounting policies in use and on the application of current and proposed accounting standards.

This advice is a by-product of the audit service rather than the result of any engagement to provide non-audit services. Consequently, as it is part of the audit service, such advice is not regarded as giving rise to any threat to the auditor's objectivity and independence.

162 For listed companies or significant affiliates of such entities, the threats to the auditor's objectivity and independence that would be created are

too high to allow the audit firm to undertake an engagement to provide any accounting services, save where the circumstances contemplated in paragraph 164 apply.

163 The audit firm's policies and procedures will set out whether there are circumstances in which accounting services are not undertaken for non-listed audited entities as described in paragraph 47 of APB Ethical Standard 1.

164 In emergency situations, the audit firm may provide a listed audited entity, or a significant affiliate of such a company, with accounting services to assist the company in the timely preparation of its financial statements. This might arise when, due to external and unforeseeable events, the audit firm personnel are the only people with the necessary knowledge of the audited entity's systems and procedures. A situation could be considered an emergency where the audit firm's refusal to provide these services would result in a severe burden for the audited entity (for example, withdrawal of credit lines), or would even threaten its going concern status. In such circumstances, the audit firm ensures that:

- (a) any staff involved in the accounting services have no involvement in the audit of the financial statements; and
- (b) the engagement would not lead to any audit firm staff or partners taking decisions or making judgments which are properly the responsibility of management.

165 For entities other than listed companies or significant affiliates of listed companies, the auditor may undertake an engagement to provide accounting services, provided that:

- (a) such services:
 - (i) do not involve initiating transactions or taking management decisions; and
 - (ii) are of a technical, mechanical or an informative nature; and
- (b) appropriate safeguards are applied to reduce the self-review threat to an acceptable level.

166 The maintenance of the accounting records and the preparation of the financial statements are the responsibility of the management of the audited entity. Accordingly, in any engagement to provide the audited entity with accounting services, the audit firm does not initiate any transactions or take any decisions or make any judgments, which are properly the responsibility of the management. These include:

- authorising or approving transactions;
- preparing originating data (including valuation assumptions);
- determining or changing journal entries, or the classifications for accounts or transactions, or other accounting records without management approval.

167 Examples of accounting services of a technical or mechanical nature or of an informative nature include:

- recording transactions for which management has determined the appropriate account classification, posting coded transactions to the general ledger, posting entries approved by management to the trial balance or providing certain data-processing services (for example, payroll);
- assistance with the preparation of the financial statements where management takes all decisions on issues requiring the exercise of judgment and has prepared the underlying accounting records.

168 Examples of safeguards that may be appropriate when accounting services are provided to an audited entity include:

- accounting services provided by the audit firm are performed by partners and staff who have no involvement in the external audit of the financial statements;
- the accounting services are reviewed by a partner or other senior staff member with appropriate expertise who is not a member of the audit team;

- the audit of the financial statements is reviewed by an audit partner who is not involved in the audit engagement to ensure that the accounting services performed have been properly and effectively assessed in the context of the audit of the financial statements.

EFFECTIVE DATE

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

170 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.

171 Where compliance with the requirements of ES 5 would result in a service not being supplied, services contracted before 31 December 2010 may continue to be provided until the earlier of either:

- (a) the completion of the specific task or the end of the contract term, where this is set out in the contract; or
- (b) 31 December 2011 (or, in the case of services prohibited under paragraph 95, 31 December 2014),

as long as the following apply:

- the engagement was permitted by existing ethical standards (including transitional provisions);
- any safeguards required by existing ethical standards continue to be applied; and
- the need for additional safeguards is assessed, including where possible any additional safeguards specified by ES 5, and if considered necessary, those additional safeguards are applied.

172 In the first year of appointment as auditor to an audited entity, an audit firm may continue to provide non-audit services which are already contracted at the date of appointment, until the earlier of either:

- (i) the completion of the specific task 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 a task or term is not defined,

provided that the need for additional safeguards is assessed and if considered necessary, those additional safeguards are applied.