

## Definitions

[Please note only definitions relating to independence are presented below]

Financial statement audit client An entity in respect of which a firm conducts a financial statement audit engagement. When the ~~audit~~ client is a listed entity, financial statement audit client will always include its related entities.

Financial statement assurance engagement A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether to provide a high level of assurance that financial statements are prepared in all material respects in accordance with an identified financial reporting framework, free of material misstatement, such as an engagement conducted in accordance with International Standards on Auditing. This includes a Statutory Audit, which is a financial statement audit required by ~~national~~ legislation or other regulation.

Assurance client ~~An entity in respect of which a firm conducts an assurance engagement~~ In an assertion-based assurance engagement, the party responsible for the subject matter information.

(For an assurance client that is a financial statement audit client see the definition of financial statement audit client.)

Assurance engagement An engagement in which a professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

(For guidance on assurance engagements see the International Framework for Assurance Engagements issued by the International Auditing and Assurance Standards Board which describes the elements and objectives of an assurance engagement and identifies engagements to which International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs) and International Standards on Assurance Engagements (ISAEs) apply.) ~~conducted to provide:~~

~~(a) A high level of assurance that the subject matter conforms in all material respects with identified suitable criteria; or~~

~~(b) A moderate level of assurance that the subject matter is plausible in the circumstances.~~

~~This would include an engagement in accordance with the International Standard on Assurance Engagements issued by the International Auditing and Assurance Standards Board or in accordance with specific standards for assurance engagements issued by the International Auditing and Assurance Board such as an audit or review of financial statements in accordance with International Standards on Auditing.~~

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|------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Assurance team                           | <p>(a) All <del>professionals participating in the assurance engagement</del><u>members of the engagement team for the assurance engagement</u>;</p> <p>(b) All others within a firm who can directly influence the outcome of the assurance engagement, including:</p> <ul style="list-style-type: none"><li>• those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement. For the purposes of a <del>an</del> <u>financial statement</u> audit engagement this includes those at all successively senior levels above the <del>lead</del> engagement partner through the firm's chief executive;</li><li>• those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and</li><li>• those who provide quality control for the assurance engagement, <u>including those who perform the engagement quality control review for the assurance engagement</u>;</li></ul> <p>and</p> <p>(c) For the purposes of a <del>an</del> <u>financial statement</u> audit client, all those within a network firm who can directly influence the outcome of the <u>financial statement</u> audit engagement.</p> |
| Close family                             | A parent, non-dependent child or sibling.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| Direct financial interest                | <p>A financial interest:</p> <ul style="list-style-type: none"><li>• Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or</li><li>• Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control.</li></ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| Directors and officers                   | Those charged with the governance of an entity, regardless of their title, which may vary from country to country.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| <u>Engagement quality control review</u> | <u>A process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| <u>Engagement team</u>                   | <u>All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |

|                             |                                                                                                                                                                                                                                                                                                                                                                  |
|-----------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Financial interest          | An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.                                                                                                                                               |
| <u>Financial statements</u> | <u>The balance sheets, income statements or profit and loss accounts, statements of changes in financial position (which may be presented in a variety of ways, for example, as a statement of cash flows or a statement of fund flows), notes and other statements and explanatory material which are identified as being part of the financial statements.</u> |
| Firm                        | <ul style="list-style-type: none"><li>• A sole practitioner, partnership or <u>other entity</u> <del>corporation</del> of professional accountants;</li><li>• An entity that controls such parties; and</li><li>• An entity controlled by such parties.</li></ul>                                                                                                |
| Immediate family            | A spouse (or equivalent) or dependent.                                                                                                                                                                                                                                                                                                                           |
| Independence                | Independence is:<br><p>(a) Independence of mind – the state of mind that permits the <del>provision</del> <u>expression</u> of an <del>opinion</del> <u>conclusion</u> without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and</p>   |

|                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|-----------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                             | (b) Independence in appearance – the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| Indirect financial interest | A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| Lead engagement partner     | <del>In connection with an audit, the partner responsible for signing the report on the consolidated financial statements of the audit client, and, where relevant, the partner responsible for signing the report in respect of any entity whose financial statements form part of the consolidated financial statements and on which a separate stand-alone report is issued. When no consolidated financial statements are prepared, the lead engagement partner would be the partner responsible for signing the report on the financial statements. The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.</del> |
| Listed entity               | An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| Network firm                | An entity under common control, ownership or management with the firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as being part of the firm nationally or internationally. <u>[to be amended pending results of network firm TF]</u>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| Office                      | A distinct sub-group, whether organized on geographical or practice lines.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| Practice                    | A sole practitioner, a partnership or a corporation of professional accountants which offers professional services to the public.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| Related entity              | An entity that has any of the following relationships with the client:<br>(a) An entity that has direct or indirect control over the client provided the client is material to such entity;<br>(b) An entity with a direct financial interest in the client provided that such entity has significant influence over the client and the interest in the client is material to such entity;<br>(c) An entity over which the client has direct or indirect control;                                                                                                                                                                                                                                                                                                                                                                |

- (d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and
- (e) An entity which is under common control with the client (hereinafter a “sister entity”) provided the sister entity and the client are both material to the entity that controls both the client and sister entity.

## SECTION 8

### Independence

8.1 It is in the public interest and, therefore, required by this Code of Ethics, that members of **assurance teams**,\* firms and, when applicable, **network firms**\* be independent of **assurance clients**.\*

8.2 Assurance engagements are ~~intended~~ designed to enhance intended users' degree of confidence about the outcome of the evaluation or measurement of a subject matter against criteria~~the credibility of information about a subject matter by evaluating whether the subject matter conforms in all material respects with suitable criteria~~. The International ~~Standard on~~ Framework for Assurance Engagements issued by the International Auditing and Assurance Standards Board describes the ~~objectives and elements~~ and objectives of an assurance engagement, and identifies engagements to which International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs) and International Standards on Assurance Engagements (ISAEs) apply. The Framework recognizes that not all engagements performed by professional accountants in public practice are assurance engagements and identifies frequently performed engagements that do not meet the definition of an assurance engagement.

~~s to provide either a high or a moderate level of assurance. The International Auditing and Assurance Standards Board has also issued specific standards for certain assurance engagements. For example, International Standards on Auditing provide specific standards for audit (high level assurance) and review (moderate level assurance) of financial statements.~~

~~Paragraphs 8.3 through 8.6 are taken from the International Standard on Assurance Engagements and describe the nature of an assurance engagement. These paragraphs are presented here only to describe the nature of an assurance engagement. To obtain a full understanding of the objectives and elements of an assurance engagement it is necessary to refer to the full text contained in the International Standard on Assurance Engagements.~~

~~8.3~~ Whether a particular engagement is an assurance engagement will depend upon whether it exhibits all the following elements:

(a) ~~A three party relationship involving:~~

(i) ~~A professional accountant;~~

(i) ~~A responsible party; and~~

(ii) ~~An intended user;~~

(b) ~~A subject matter;~~

(c) ~~Suitable criteria;~~

(d) ~~An engagement process; and~~

(e) ~~A conclusion.~~

\* See Definitions.

- The responsible party and the intended user will often be from separate organizations but need not be. A responsible party and an intended user may both be within the same organization. For example, a governing body may seek assurance about information provided by a component of that organization. The relationship between the responsible party and the intended user needs to be viewed within the context of a specific engagement.
- ~~8.4~~ There is a broad range of engagements to provide a high or moderate level of assurance. Such engagements may include:
- Engagements to report on a broad range of subject matters covering financial and non-financial information;
  - Attest and direct reporting engagements;
  - Engagements to report internally and externally; and
  - Engagements in the private and public sector.
- ~~8.5~~ The subject matter of an assurance engagement may take many forms, such as the following:
- Data (for example, historical or prospective financial information, statistical information, performance indicators).
  - Systems and processes (for example, internal controls).
  - Behavior (for example, corporate governance, compliance with regulation, human resource practices).
- ~~8.96~~ Not all engagements performed by professional accountants are assurance engagements. Other engagements frequently performed by professional accountants that are not assurance engagements include:
- Agreed-upon procedures;
  - Compilation of financial or other information;
  - Preparation of tax returns when no conclusion is expressed, and tax consulting;
  - Management consulting; and
  - Other advisory services.
- ~~8.7~~ This section of the Code of Ethics (this section) provides a framework, built on principles, for identifying, evaluating and responding to threats to independence. The framework establishes principles that members of assurance teams, firms and network firms should use to identify threats to independence, evaluate the significance of those threats, and, if the threats are other than clearly insignificant, identify and apply safeguards to eliminate the threats or reduce them to an acceptable level. Judgment is needed to determine which safeguards are to be applied. Some safeguards may eliminate the threat while others may reduce the threat to an acceptable level. This section requires members of assurance teams, firms and network firms to apply the principles to the particular circumstances under consideration. The examples presented are intended to illustrate the application of the principles in this section and are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances that may create threats to independence. Consequently, it is not sufficient for a member of an assurance team, a firm or a network

~~firm merely to comply with the examples presented, rather they should apply the principles in this section to the particular circumstances they face.~~

### **A Conceptual Approach to Independence**

8.3138 Independence requires:

~~(a)~~ *Independence of Mind*

The state of mind that permits the ~~provision-expression~~ of an ~~opinion-conclusion~~ without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

~~(b)~~ *Independence in Appearance*

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

8.149 The use of the word “independence” on its own may create misunderstandings. Standing alone, the word may lead observers to suppose that a person exercising professional judgment ought to be free from all economic, financial and other relationships. This is impossible, as every member of society has relationships with others. Therefore, the significance of economic, financial and other relationships should also be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

8.5150 Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist, requiring the application of different safeguards. A conceptual framework that requires firms and members of assurance teams to identify, evaluate and address threats to independence, rather than merely comply with a set of specific rules which may be arbitrary, is, therefore, in the public interest.

### **A Conceptual Approach to Independence**

8.6161 This section ~~is based on such~~ provides a conceptual framework for identifying, evaluating and responding to threats to independence. The framework requires members of assurance teams, firms and network firms to identify threats to independence, evaluate the significance of those threats, and, if the threats are other than clearly insignificant, identify and apply safeguards to eliminate the threats or reduce them to an acceptable level. Judgment is needed to determine which safeguards are to be applied. Some safeguards may eliminate the threat while others may reduce the threat to an acceptable level. This section requires members of assurance teams, firms and network firms to apply the framework to the particular circumstances under consideration. In addition to identifying relationships between the firm, network firms, members of the assurance team and the assurance client, consideration should be given to whether relationships between individuals outside of the assurance team and the assurance client create threats to independence.

8.7 The examples presented in this section are intended to illustrate the application of the framework and are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances that may create threats to independence. Consequently, it is not sufficient for a member of an assurance team, a firm or a network firm merely to comply with the examples presented, rather they should apply the framework to the particular circumstances they face.

~~approach, one that takes into account threats to independence, accepted safeguards and the public interest. Under this approach, firms and members of assurance teams have an obligation to identify and evaluate circumstances and relationships that create threats to independence and to take appropriate action to eliminate these threats or to reduce them to an acceptable level by the application of safeguards. In addition to identifying and evaluating relationships between the firm, network firms, members of the assurance team and the assurance client, consideration should be given to whether relationships between individuals outside of the assurance team and the assurance client create threats to independence.~~

~~8.12 This section provides a framework of principles that members of assurance teams, firms and network firms should use to identify threats to independence, evaluate the significance of those threats, and, if the threats are other than clearly insignificant, identify and apply safeguards to eliminate the threats or reduce them to an acceptable level, such that independence of mind and independence in appearance are not compromised.~~

~~8.87+83 The principles in this section apply to all assurance engagements. The nature of the threats to independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level differ depending on the characteristics of the individual assurance engagement: whether the assurance engagement is an **financial statement audit engagement**\* or another type of engagement; and in the case of an assurance engagement that is not an **financial statement** audit engagement, the purpose, subject matter **information**, and intended users of the report, and whether the engagement is an **assertion-based engagement** or a **direct reporting engagement**. A firm should, therefore, evaluate the relevant circumstances, the nature of the assurance engagement and the threats to independence in deciding whether it is appropriate to accept or continue an engagement, as well as the nature of the safeguards required and whether a particular individual should be a member of the assurance team.~~

~~8.98+8a In an assurance engagement, the professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.~~

~~8.10 The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. The term “subject matter information” is used to mean the outcome of the evaluation or measurement of subject matter. For example:~~

- ~~• The recognition, measurement, presentation and disclosure represented in the financial statements (subject matter information) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure, such as International Financial Reporting Standards, (criteria) to an entity’s financial position, financial performance and cash flows (subject matter).~~

- An assertion about the effectiveness of internal control (subject matter information) results from applying a framework for evaluating the effectiveness of internal control, such, for example, as applying COSO<sup>1</sup> or CoCo<sup>2</sup>, (criteria) to internal control, a process (subject matter).
- 8.11 Assurance engagements involve three separate parties: a public accountant in public practice, a responsible party and intended users.
- 8.12 In an assertion-based engagement, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by a responsible party that is made available to the intended users.
- 8.13 In a direct reporting engagement the professional accountant in public practice either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The responsible party may or may not be the party who engages the professional accountant in public practice. The subject matter information is provided to the intended users in the assurance report.
- 8.14 Direct reporting engagements are not commonly performed by professional accountants in public practice. Before accepting such an engagement the principles in this section should be applied, and the professional accountant in public practice should carefully consider whether there are adequate safeguards available to reduce threats to independence to an acceptable level. If the professional accountant in public practice directly performs the evaluation or measurement of the subject matter the threat to independence may be so significant no safeguard would be available to reduce the threat to independence to an acceptable level.
- 8.15 Subject to paragraph 8.14 the remainder of this section applies only to assertion-based engagements.

#### Financial Statement Audit Engagements

- 8.164 Financial statement Aaudit engagements ~~provide assurance~~are relevant to a wide range of potential users; consequently, in addition to independence of mind, independence in appearance is of particular significance. Accordingly, for **financial statement audit clients**,\* the members of the assurance team, the firm and network firms are required to be independent of the financial statement audit client. Such independence requirements included prohibitions regarding certain relationships between members of the assurance team and directors, officers and employees of the client in a position to exert direct and significant influence over the subject matter information (the financial statements). Also, consideration should be given to whether threats to independence are created by relationships with employees of the client in a position to exert direct and significant influence over the subject matter (the financial position, financial performance and cash flows).

#### Other Assertion-based Engagements

<sup>1</sup> “Internal Control – Integrated Framework” The Committee of Sponsoring Organizations of the Treadway Commission.

<sup>2</sup> “Guidance on Assessing Control – The CoCo Principles” Criteria of Control Board, The Canadian Institute of Chartered Accountants.

\* See Definitions.

8.17 In an assertion-based engagement where the client is not a financial statement audit client, the members of the assurance team and the firm are required to be independent of the assurance client. Such independence requirements included prohibitions regarding certain relationships between members of the assurance team and directors, officers and employees of the client in a position to exert direct and significant influence over the subject matter information. Also, consideration should be given to whether threats to independence are created by relationships with employees of the client in a position to exert direct and significant influence over the subject matter of the engagement. Consideration should also be given to any threats that the firm has reason to believe may be created by network firm interests and relationships.

8.18 In the majority of assertion-based engagements there is one party responsible for both the subject matter and the subject matter information. However, in some assertion-based engagements there are two responsible parties, for example, when a professional accountant in public practice is engaged by an environmental consultant to perform an assurance engagement regarding a report that the environmental consultant has prepared about a company's sustainability practices, for distribution intended users, the environmental consultant (the assurance client) is the party responsible for the subject matter information and the company is the party responsible for the subject matter.

8.19 In an assertion-based engagement where there are two responsible parties, the members of the assurance team and the firm are required to be independent of the assurance client (the party responsible for the subject matter information). In addition, consideration should be given to any threats the firm has reason to believe may be created by interest and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.

~~Similar considerations in the case of assurance engagements provided to non-audit assurance clients require the members of the assurance team and the firm to be independent of the non-audit assurance client. In the case of these engagements, consideration should be given to any threats that the firm has reason to believe may be created by network firm interests and relationships.~~

**8.2015 For alternative versions of this paragraph please see Agenda Paper 3**

### Restricted Use Reports

8.21 In the case of an assurance-assertion-based report in respect of ~~to~~ a non-financial statement-audit assurance client expressly restricted for use by identified users, the users of the report are considered to be knowledgeable as to the purpose, subject matter information and limitations of the report through their participation in establishing the nature and scope of the firm's instructions to deliver the services, including the criteria ~~by~~ against which the subject matter are to be evaluated or measured. This knowledge and the enhanced ability of the firm to communicate about safeguards with all users of the report increase the effectiveness of safeguards to independence in appearance. These circumstances may be taken into account by the firm in evaluating the threats to independence and considering the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level. At a minimum, it will be necessary to apply the provisions of this section in evaluating the independence of members of the assurance team and their immediate and close family. \* Further, if the firm had a material financial interest, \* whether direct or indirect, in the assurance client, the self-interest threat created

would be so significant no safeguard could reduce the threat to an acceptable level. Limited consideration of any threats created by network firm interests and relationships may be sufficient.

8.16—Accordingly:

~~(f) For assurance engagements provided to an audit client, the members of the assurance team, the firm and network firms are required to be independent of the client; For assurance engagements provided to clients that are not audit clients, when the report is not expressly restricted for use by identified users, the members of the assurance team and the firm are required to be independent of the client; and~~

~~(g) For assurance engagements provided to clients that are not audit clients, when the assurance report is expressly restricted for use by identified users, the members of the assurance team are required to be independent of the client. In addition, the firm should not have a material **direct or indirect financial interest**<sup>\*</sup> in the client.~~

These independence requirements for assurance engagements are illustrated as follows:

| Client                     | Type of Assurance Engagement           |                                  |                                                            |
|----------------------------|----------------------------------------|----------------------------------|------------------------------------------------------------|
|                            | Audit                                  | Non-audit—<br>not restricted use | Non-audit—<br>restricted use                               |
| Audit client               | Assurance team, firm and network firms |                                  |                                                            |
| Non-audit assurance client |                                        | Assurance team and firm          | Assurance team and firm has no material financial interest |

Other considerations

8.2247 The threats and safeguards identified in this section are generally discussed in the context of interests or relationships between the firm, network firms, a member of the assurance team and the assurance client. In the case of a ~~listed financial statement~~ audit client that is a listed entity, the firm and any network firms are required to consider the interests and relationships that involve that client’s related entities. Ideally those entities and the interests and relationships should be identified in advance. For all other assurance clients, when the assurance team has reason to believe that a **related entity**<sup>\*</sup> of such an assurance client is relevant to the evaluation of the firm’s independence of the client, the assurance team should consider that related entity when evaluating independence and applying appropriate safeguards.

8.2318 The evaluation of threats to independence and subsequent action should be supported by evidence obtained before accepting the engagement and while it is being performed. The obligation to make such an evaluation and take action arises when a firm, a network firm

\* See Definitions.

\* See Definitions.

or a member of the assurance team knows, or could reasonably be expected to know, of circumstances or relationships that might compromise independence. There may be occasions when the firm, a network firm or an individual inadvertently violates this section. If such an inadvertent violation occurs, it would generally not compromise independence with respect to an assurance client provided the firm has appropriate quality control policies and procedures in place to promote independence and, once discovered, the violation is corrected promptly and any necessary safeguards are applied.

8.2419 Throughout this section, reference is made to significant and clearly insignificant threats in the evaluation of independence. In considering the significance of any particular matter, qualitative as well as quantitative factors should be taken into account. A matter should be considered clearly insignificant only if it is deemed to be both trivial and inconsequential.

The shaded paragraphs have been revised by the Code re-draft TF as part of their work.

### **Objective and Structure of this Section**

8.250 The objective of this section is to assist firms and members of assurance teams in:

~~(k)~~(a) Identifying threats to independence;

~~(l)~~(b) Evaluating whether these threats are clearly insignificant; and

~~(m)~~(c) In cases when the threats are not clearly insignificant, identifying and applying appropriate safeguards to eliminate or reduce the threats to an acceptable level.

In situations when no safeguards are available to reduce the threat to an acceptable level, the only possible actions are to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement.

8.261 This section outlines the threats to independence (paragraphs 8.28 through 8.33). It then analyzes safeguards capable of eliminating these threats or reducing them to an acceptable level (paragraphs 8.34 through 8.47). It concludes with some examples of how this conceptual approach to independence is to be applied to specific circumstances and relationships. The examples discuss threats to independence that may be created by specific circumstances and relationships (paragraphs 8.100 onwards). Professional judgment is used to determine the appropriate safeguards to eliminate threats to independence or to reduce them to an acceptable level. In certain examples, the threats to independence are so significant the only possible actions are to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement. In other examples, the threat can be eliminated or reduced to an acceptable level by the application of safeguards. The examples are not intended to be all-inclusive.

8.272 When threats to independence that are not clearly insignificant are identified, and the firm decides to accept or continue the assurance engagement, the decision should be documented. The documentation should include a description of the threats identified and the safeguards applied to eliminate or reduce the threats to an acceptable level.

8.283 The evaluation of the significance of any threats to independence and the safeguards necessary to reduce any threats to an acceptable level, takes into account the public interest. Certain entities may be of significant public interest because, as a result of their business, their size or their corporate status they have a wide range of stakeholders. Examples of such entities might include listed companies, credit institutions, insurance

companies, and pension funds. Because of the strong public interest in the financial statements of listed entities, certain paragraphs in this section deal with additional matters that are relevant to the financial statement audit of listed entities. Consideration should be given to the application of the principles set out in this section framework in relation to the financial statement audit of listed entities to other financial statement audit clients that may be of significant public interest.

### National Perspectives

- 8.2924 This section establishes a conceptual framework for independence requirements for assurance engagements that is the international standard on which national standards should be based. Accordingly, no member body or firm is allowed to apply less stringent standards than those stated in this section. When, however, member bodies or firms are prohibited from complying with certain parts of this section by law or regulation they should comply with all other parts of this section.
- 8.3025 Certain examples in this section indicate how the principles are framework is to be applied to financial statement audit engagements for a listed entity\* audit engagements. When a member body chooses not to differentiate between listed entities and other entities audit engagements and other audit engagements, the examples that relate to listed entity financial statements audit engagements for listed entities should be considered to apply to all financial statement audit engagements.
- 8.3126 When a firm conducts an assurance engagement in accordance with the International Standard on Assurance Engagements or with specific standards for assurance engagements issued by the International Auditing and Assurance Standards Board such as an audit or review of financial statements in accordance with International Standards on Auditing, the members of the assurance team and the firm should comply with this section unless they are prohibited from complying with certain parts of this section by law or regulation. In such cases, the members of the assurance team and the firm should comply with all other parts of this section.
- 8.3227 Some countries and cultures may have set out, either by legislation or common practice, different definitions of relationships from those used in this section. For example, some national legislators or regulators may have prescribed lists of individuals who should be regarded as close family that differ from the definition contained in this section. Firms, network firms and members of assurance teams should be aware of those differences and comply with the more stringent requirements.

### Threats to Independence

- 8.3328 Independence is potentially affected by self-interest, self-review, advocacy, familiarity and intimidation threats.
- 8.3429 “Self-Interest Threat” occurs when a firm or a member of the assurance team could benefit from a financial interest in, or other self-interest conflict with, an assurance client.

Examples of circumstances that may create this threat include, but are not limited to:

- A direct financial interest or material indirect financial interest in an assurance client;
- A loan or guarantee to or from an assurance client or any of its **directors or officers**;

\* See Definitions.

\* See Definitions.

- Undue dependence on total fees from an assurance client;
- Concern about the possibility of losing the engagement;
- Having a close business relationship with an assurance client;
- Potential employment with an assurance client; and
- Contingent fees relating to assurance engagements.

8.359 “Self-Review Threat” occurs when (1) any product or judgment of a previous assurance engagement or non-assurance engagement needs to be re-evaluated in reaching conclusions on the assurance engagement or (2) when a member of the assurance team was previously a director or officer of the assurance client, or was an employee in a position to exert direct and significant influence over the subject matter information of the assurance engagement.

Examples of circumstances that may create this threat include, but are not limited to:

- A member of the assurance team being, or having recently been, a director or officer of the assurance client;
- A member of the assurance team being, or having recently been, an employee of the assurance-financial statement audit client in a position to exert direct and significant influence over the subject matter of the assurance engagement financial statements of the client;
- Performing services for an assurance client that directly affect the subject matter information of the assurance engagement; and
- Preparation of original data used to generate financial statements or preparation of other records that are the subject matter information of the assurance engagement.

8.364 “Advocacy Threat” occurs when a firm, or a member of the assurance team, promotes, or may be perceived to promote, an assurance client’s position or opinion to the point that objectivity may, or may be perceived to be, compromised. Such may be the case if a firm or a member of the assurance team were to subordinate their judgment to that of the client.

Examples of circumstances that may create this threat include, but are not limited to:

- Dealing in, or being a promoter of, shares or other securities in an assurance client; and
- Acting as an advocate on behalf of an assurance client in litigation or in resolving disputes with third parties.

8.372 “Familiarity Threat” occurs when, by virtue of a close relationship with an assurance client, its directors, officers or employees, a firm or a member of the assurance team becomes too sympathetic to the client’s interests.

Examples of circumstances that may create this threat include, but are not limited to:

- A member of the assurance team having an **immediate family**\* member or close family member who is a director or officer of the assurance client;
- A member of the assurance team having an immediate family member or close family member who, as an employee of the assurance client, is in a position to exert direct

\* See Definitions.

and significant influence over the subject matter information of the assurance engagement;

- A former partner of the firm being a director, officer of the assurance client or an employee in a position to exert direct and significant influence over the subject matter information of the assurance engagement;
- Long association of a senior member of the assurance team with the assurance client; and
- Acceptance of gifts or hospitality, unless the value is clearly insignificant, from the assurance client, its directors, officers or employees.

8.383 “Intimidation Threat” occurs when a member of the assurance team may be deterred from acting objectively and exercising professional skepticism by threats, actual or perceived, from the directors, officers or employees of an assurance client.

Examples of circumstances that may create this threat include, but are not limited to:

- Threat of replacement over a disagreement with the application of an accounting principle; and
- Pressure to reduce inappropriately the extent of work performed in order to reduce fees.

### **Safeguards**

8.3439 The firm and members of the assurance team have a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats or reduce them to an acceptable level.

8.4035 When threats are identified, other than those that are clearly insignificant, appropriate safeguards should be identified and applied to eliminate the threats or reduce them to an acceptable level. This decision should be documented. The nature of the safeguards to be applied will vary depending upon the circumstances. Consideration should always be given to what a reasonable and informed third party having knowledge of all relevant information, including safeguards applied, would reasonably conclude to be unacceptable. The consideration will be affected by matters such as the significance of the threat, the nature of the assurance engagement, the intended users of the assurance report and the structure of the firm.

8.4136 Safeguards fall into three broad categories:

- (a) Safeguards created by the profession, legislation or regulation;
- (b) Safeguards within the assurance client; and
- (c) Safeguards within the firm’s own systems and procedures.

The firm and the members of the assurance team should select appropriate safeguards to eliminate or reduce threats to independence, other than those that are clearly insignificant, to an acceptable level.

8.4237 Safeguards created by the profession, legislation or regulation, include:

- Educational, training and experience requirements for entry into the profession;
- Continuing education requirements;

- Professional standards and monitoring and disciplinary processes;
- External review of a firm's quality control system; and
- Legislation governing the independence requirements of the firm.

8.4338 Safeguards within the assurance client, include:

- When the assurance client's management appoints the firm, persons other than management ratify or approve the appointment;
- The assurance client has competent employees to make managerial decisions;
- Policies and procedures that emphasize the assurance client's commitment to fair financial reporting;
- Internal procedures that ensure objective choices in commissioning non-assurance engagements; and
- A corporate governance structure, such as an audit committee, that provides appropriate oversight and communications regarding a firm's services.

8.4439 Audit committees can have an important corporate governance role when they are independent of client management and can assist the Board of Directors in satisfying themselves that a firm is independent in carrying out its audit role. There should be regular communications between the firm and the audit committee (or other governance body if there is no audit committee) of listed entities regarding relationships and other matters that might, in the firm's opinion, reasonably be thought to bear on independence.

8.450 Firms should establish policies and procedures relating to independence communications with audit committees, or others charged with governance. In the case of the [financial statement](#) audit of listed entities, the firm should communicate orally and in writing at least annually, all relationships and other matters between the firm, network firms and the [financial statement](#) audit client that in the firm's professional judgment may reasonably be thought to bear on independence. Matters to be communicated will vary in each circumstance and should be decided by the firm, but should generally address the relevant matters set out in this section.

8.461 Safeguards within the firm's own systems and procedures may include firm-wide safeguards such as:

- Firm leadership that stresses the importance of independence and the expectation that members of assurance teams will act in the public interest;
- Policies and procedures to implement and monitor quality control of assurance engagements;
- Documented independence policies regarding the identification of threats to independence, the evaluation of the significance of these threats and the identification and application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level;
- Internal policies and procedures to monitor compliance with firm policies and procedures as they relate to independence;
- Policies and procedures that will enable the identification of interests or relationships between the firm or members of the assurance team and assurance clients;

- Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single assurance client;
- Using different partners and teams with separate reporting lines for the provision of non-assurance services to an assurance client;
- Policies and procedures to prohibit individuals who are not members of the assurance team from influencing the outcome of the assurance engagement;
- Timely communication of a firm's policies and procedures, and any changes thereto, to all partners and professional staff, including appropriate training and education thereon;
- Designating a member of senior management as responsible for overseeing the adequate functioning of the safeguarding system;
- Means of advising partners and professional staff of those assurance clients and related entities from which they must be independent;
- A disciplinary mechanism to promote compliance with policies and procedures; and
- Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them; this includes informing staff of the procedures open to them.

8.472 Safeguards within the firm's own systems and procedures may include engagement specific safeguards such as:

- Involving an additional professional accountant to review the work done or otherwise advise as necessary. This individual could be someone from outside the firm or network firm, or someone within the firm or network firm who was not otherwise associated with the assurance team;
- Consulting a third party, such as a committee of independent directors, a professional regulatory body or another professional accountant;
- Rotation of senior personnel;
- Discussing independence issues with the audit committee or others charged with governance;
- Disclosing to the audit committee, or others charged with governance, the nature of services provided and extent of fees charged;
- Policies and procedures to ensure members of the assurance team do not make, or assume responsibility for, management decisions for the assurance client;
- Involving another firm to perform or re-perform part of the assurance engagement;
- Involving another firm to re-perform the non-assurance service to the extent necessary to enable it to take responsibility for that service; and
- Removing an individual from the assurance team, when that individual's financial interests or relationships create a threat to independence.

8.483 When the safeguards available, such as those described above, are insufficient to eliminate the threats to independence or to reduce them to an acceptable level, or when a firm chooses not to eliminate the activities or interests creating the threat, the only course of action available will be the refusal to perform, or withdrawal from, the assurance engagement.

### Engagement Period

8.4944 The members of the assurance team and the firm should be independent of the assurance client during the period of the assurance engagement. The period of the engagement starts when the assurance team begins to perform assurance services and ends when the assurance report is issued, except when the assurance engagement is of a recurring nature. If the assurance engagement is expected to recur, the period of the assurance engagement ends with the notification by either party that the professional relationship has terminated or the issuance of the final assurance report, whichever is later.

8.450 In the case of a financial statement audit engagement, the engagement period includes the period covered by the financial statements reported on by the firm. When an entity becomes a financial statement audit client during or after the period covered by the financial statements that the firm will report on, the firm should consider whether any threats to independence may be created by:

- Financial or business relationships with the audit client during or after the period covered by the financial statements, but prior to the acceptance of the financial statement audit engagement; or
- Previous services provided to the audit client.

Similarly, in the case of an assurance engagement that is not a financial statement audit engagement, the firm should consider whether any financial or business relationships or previous services may create threats to independence.

8.5146 If a non-assurance services ~~were was~~ provided to the financial statement audit client during or after the period covered by the financial statements but before the commencement of professional services in connection with the financial statement audit and ~~these~~ services would be prohibited during the period of the audit engagement, consideration should be given to the threats to independence, if any, arising from ~~these~~ services. If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Discussing independence issues related to the provision of the non-assurance services with those charged with governance of the client, such as the audit committee;
- Obtaining the ~~audit~~ client's acknowledgement of responsibility for the results of the non-assurance services;
- Precluding personnel who provided the non-assurance services from participating in the financial statement audit engagement; and
- Engaging another firm to review the results of the non-assurance services or having another firm re-perform the non-assurance services to the extent necessary to enable it to take responsibility for the ~~these~~ services.

8.5247 A ~~n~~ non-assurance services ~~were was~~ provided to a non-listed financial statement audit client will not impair the firm's independence when the client becomes a listed entity provided:

- (a) The previous non-assurance services ~~were was~~ permissible under this section for non-listed financial statement audit clients;
- (b) The services will be terminated within a reasonable period of time of the client becoming a listed entity, if they are impermissible under this section for financial statement ~~listed~~ audit clients that are listed entities; and

- (c) The firm has implemented appropriate safeguards to eliminate any threats to independence arising from the previous services or reduce them to an acceptable level.

**Effective Date**

- 8.5348 This section is applicable to assurance engagements when the assurance report is dated on or after December 31, 2004. Earlier application is encouraged.

**Application of Principles-Framework to Specific Situations**

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## Introduction

- 8.100 The following examples describe specific circumstances and relationships that may create threats to independence. The examples describe the potential threats created and the safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level in each circumstance. The examples are not all-inclusive. In practice, the firm, network firms and the members of the assurance team will be required to assess the implications of similar, but different, circumstances and relationships and to determine whether safeguards, including the safeguards in paragraphs 8.37 through 8.42 can be applied to satisfactorily address the threats to independence. Paragraphs 8.1 through 8.48 of this section provide conceptual guidance to assist in this process.
- 8.101 Some of the examples deal with financial statement audit clients while others deal with assertion-based engagements for assurance-clients that are not financial statement audit clients. The examples illustrate how safeguards should be applied to fulfill the requirement for the members of the assurance team, the firm and network firms to be independent of a financial statement audit client, and for the members of the assurance team and the firm to be independent of an assurance client that is not a financial statement audit client. The examples do not include assurance reports to a non-financial statement audit assurance-client expressly restricted for use by identified users. As stated in paragraph 8.2115 for such engagements, members of the assurance team and their immediate and close family are required to be independent of the assurance client. Further, the firm should not have a material financial interest, direct or indirect, in the assurance client. The examples do not include direct reporting engagements. As explained in paragraph 8.14, before accepting such an engagement careful consideration should be given to whether there are adequate safeguards available to reduce threats to independence to an acceptable level.
- 8.101a The examples illustrate how the framework applies to financial statement audit clients and other assurance clients. The examples should be read in conjunction with paragraphs 8.17-8.19 which explain that, in the majority of assertion-based engagements, there is one responsible party and that responsible party comprises the assurance client. However, in some assertion-based engagements there are two responsible parties. In such circumstances, consideration should be given to any threats the firm has reason to believe may be created by interests and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.
- 8.101b The examples should also be read in conjunction with paragraph 8.20 which explains that in certain limited circumstances, to be completed. Remainder of paragraph will be consistent with decision taken regarding paragraph 20.

## Financial Interests

- 8.102 A financial interest in an assurance client may create a self-interest threat. In evaluating the significance of the threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, it is necessary to examine the nature of the financial interest. This includes an evaluation of the role of the person holding the financial interest, the materiality of the financial interest and the type of financial interest (direct or indirect).
- 8.103 When evaluating the type of financial interest, consideration should be given to the fact that financial interests range from those where the individual has no control over the

investment vehicle or the financial interest held (e.g., a mutual fund, unit trust or similar intermediary vehicle) to those where the individual has control over the financial interest (e.g., as a trustee) or is able to influence investment decisions. In evaluating the significance of any threat to independence, it is important to consider the degree of control or influence that can be exercised over the intermediary, the financial interest held, or its investment strategy. When control exists, the financial interest should be considered direct. Conversely, when the holder of the financial interest has no ability to exercise such control the financial interest should be considered indirect.

*Provisions Applicable to All Assurance Clients*

8.104 If a member of the assurance team, or their immediate family member, has a direct financial interest, or a material indirect financial interest, in the assurance client, the self-interest threat created would be so significant the only safeguards available to eliminate the threat or reduce it to an acceptable level would be to:

- Dispose of the direct financial interest prior to the individual becoming a member of the assurance team;
- Dispose of the indirect financial interest in total or dispose of a sufficient amount of it so that the remaining interest is no longer material prior to the individual becoming a member of the assurance team; or
- Remove the member of the assurance team from the assurance engagement.

8.105 If a member of the assurance team, or their immediate family member receives, by way of, for example, an inheritance, gift or, as a result of a merger, a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat would be created. The following safeguards should be applied to eliminate the threat or reduce it to an acceptable level:

- Disposing of the financial interest at the earliest practical date; or
- Removing the member of the assurance team from the assurance engagement.

During the period prior to disposal of the financial interest or the removal of the individual from the assurance team, consideration should be given to whether additional safeguards are necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Discussing the matter with those charged with governance, such as the audit committee; or
- Involving an additional professional accountant to review the work done, or otherwise advise as necessary.

8.106 When a member of the assurance team knows that his or her close family member has a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat may be created. In evaluating the significance of any threat, consideration should be given to the nature of the relationship between the member of the assurance team and the close family member and the materiality of the financial interest. Once the significance of the threat has been evaluated, safeguards should be considered and applied as necessary. Such safeguards might include:

- The close family member disposing of all or a sufficient portion of the financial interest at the earliest practical date;
- Discussing the matter with those charged with governance, such as the audit committee;
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team with the close family relationship or otherwise advise as necessary; or
- Removing the individual from the assurance engagement.

8.107 When a firm or a member of the assurance team holds a direct financial interest or a material indirect financial interest in the assurance client as a trustee, a self-interest threat may be created by the possible influence of the trust over the assurance client. Accordingly, such an interest should only be held when:

- The member of the assurance team, an immediate family member of the member of the assurance team, and the firm are not beneficiaries of the trust;
- The interest held by the trust in the assurance client is not material to the trust;
- The trust is not able to exercise significant influence over the assurance client; and
- The member of the assurance team or the firm does not have significant influence over any investment decision involving a financial interest in the assurance client.

8.108 Consideration should be given to whether a self-interest threat may be created by the financial interests of individuals outside of the assurance team and their immediate and close family members. Such individuals would include:

- Partners, and their immediate family members, who are not members of the assurance team;
- Partners and managerial employees who provide non-assurance services to the assurance client; and
- Individuals who have a close personal relationship with a member of the assurance team.

Whether the interests held by such individuals may create a self-interest threat will depend upon factors such as:

- The firm's organizational, operating and reporting structure; and
- The nature of the relationship between the individual and the member of the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Where appropriate, policies to restrict people from holding such interests;
- Discussing the matter with those charged with governance, such as the audit committee; or
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done or otherwise advise as necessary.

- 8.109 An inadvertent violation of this section as it relates to a financial interest in an assurance client would not impair the independence of the firm, the network firm or a member of the assurance team when:
- (a) The firm, and the network firm, have established policies and procedures that require all professionals to report promptly to the firm any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;
  - (b) The firm, and the network firm, promptly notify the professional that the financial interest should be disposed of; and
  - (c) The disposal occurs at the earliest practical date after identification of the issue, or the professional is removed from the assurance team.
- 8.110 When an inadvertent violation of this section relating to a financial interest in an assurance client has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or
  - Excluding the individual from any substantive decision-making concerning the assurance engagement.

*Provisions Applicable to Financial Statement Audit Clients*

- 8.111 If a firm, or a network firm, has a direct financial interest in a financial statement audit client of the firm the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.
- 8.112 If a firm, or a network firm, has a material indirect financial interest in a financial statement audit client of the firm a self-interest threat is also created. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.
- 8.113 If a firm, or a network firm, has a material financial interest in an entity that has a controlling interest in a financial statement audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the financial interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.
- 8.114 If the retirement benefit plan of a firm, or network firm, has a financial interest in a financial statement audit client a self-interest threat may be created. Accordingly, the significance of any such threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.
- 8.115 If other partners, including partners who do not perform assurance engagements, or their immediate family, in the **office**\* in which the **lead-engagement partner**\* practices in

\* See Definitions.

- connection with the financial statement audit hold a direct financial interest or a material indirect financial interest in that audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such partners or their immediate family should not hold any such financial interests in such an audit client.
- 8.116 The office in which the ~~lead~~ engagement partner practices in connection with the financial statement audit is not necessarily the office to which that partner is assigned. Accordingly, when the ~~lead~~ engagement partner is located in a different office from that of the other members of the assurance team, judgment should be used to determine in which office the partner practices in connection with that audit.
- 8.117 If other partners and managerial employees who provide non-assurance services to the financial statement audit client, except those whose involvement is clearly insignificant, or their immediate family, hold a direct financial interest or a material indirect financial interest in the audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such personnel or their immediate family should not hold any such financial interests in such an audit client.
- 8.118 A financial interest in a ~~an~~ financial statement audit client that is held by an immediate family member of (a) a partner located in the office in which the ~~lead~~ engagement partner practices in connection with the audit, or (b) a partner or managerial employee who provides non-assurance services to the audit client is not considered to create an unacceptable threat provided it is received as a result of their employment rights (e.g., pension rights or share options) and, where necessary, appropriate safeguards are applied to reduce any threat to independence to an acceptable level.
- 8.119 A self-interest threat may be created if the firm, or the network firm, or a member of the assurance team has an interest in an entity and a ~~an~~ financial statement audit client, or a director, officer or controlling owner thereof also has an investment in that entity. Independence is not compromised with respect to the audit client if the respective interests of the firm, the network firm, or member of the assurance team, and the audit client, or director, officer or controlling owner thereof are both immaterial and the audit client cannot exercise significant influence over the entity. If an interest is material, to either the firm, the network firm or the audit client, and the audit client can exercise significant influence over the entity, no safeguards are available to reduce the threat to an acceptable level and the firm, or the network firm, should either dispose of the interest or decline the audit engagement. Any member of the assurance team with such a material interest should either:
- (a) Dispose of the interest;
  - (b) Dispose of a sufficient amount of the interest so that the remaining interest is no longer material; or
  - (c) Withdraw from the audit.

*Provisions Applicable to Non-Financial Statement Audit Assurance Clients*

- 8.120 If a firm has a direct financial interest in an assurance client that is not a ~~an~~ financial statement audit client the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.

- 8.121 If a firm has a material indirect financial interest in an assurance client that is not a financial statement audit client a self-interest threat is also created. The only action appropriate to permit the firm to perform the engagement would be for the firm to either dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.
- 8.122 If a firm has a material financial interest in an entity that has a controlling interest in an assurance client that is not a financial statement audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. The only action appropriate to permit the firm to perform the engagement would be for the firm either to dispose of the financial interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.
- 8.123 When a restricted use report for an assurance engagement that is not a financial statement audit engagement is issued, exceptions to the provisions in paragraphs 8.104 through 8.108 and 8.120 through 8.122 are set out in 8.15.

### **Loans and Guarantees**

- 8.124 A loan from, or a guarantee thereof by of a loan, from an assurance client that is a bank or a similar institution, to the firm would not create a threat to independence provided the loan, or guarantee, is made under normal lending procedures, terms and requirements and the loan is immaterial to both the firm and the assurance client. If the loan is material to the assurance client or the firm it may be possible, through the application of safeguards, to reduce the self-interest threat created to an acceptable level. Such safeguards might include involving an additional professional accountant from outside the firm, or network firm, to review the work performed.
- 8.125 A loan from, or a guarantee thereof by of a loan, from an assurance client that is a bank or a similar institution, to a member of the assurance team or their immediate family would not create a threat to independence provided the loan, or guarantee, is made under normal lending procedures, terms and requirements. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.
- 8.126 Similarly, deposits made by, or brokerage accounts of, a firm or a member of the assurance team with an assurance client that is a bank, broker or similar institution would not create a threat to independence provided the deposit or account is held under normal commercial terms.
- 8.127 If the firm, or a member of the assurance team, makes a loan to an assurance client, that is not a bank or similar institution, or guarantees such an assurance client's borrowing, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.
- 8.128 Similarly, if the firm or a member of the assurance team accepts a loan from, or has borrowing guaranteed by, an assurance client that is not a bank or similar institution, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.
- 8.129 The examples in paragraphs 8.124 through 8.128 relate to loans and guarantees between the firm and an assurance client. In the case of a financial statement audit engagement, the provisions should be applied to the firm, all network firms and the audit client.

**Close Business Relationships With Assurance Clients**

8.130 A close business relationship between a firm or a member of the assurance team and the assurance client or its management, or between the firm, a network firm and a financial statement audit client, will involve a commercial or common financial interest and may create self-interest and intimidation threats. The following are examples of such relationships:

- Having a material financial interest in a joint venture with the assurance client or a controlling owner, director, officer or other individual who performs senior managerial functions for that client.
- Arrangements to combine one or more services or products of the firm with one or more services or products of the assurance client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the assurance client's products or services, or the assurance client acts as the distributor or marketer of the products or services of the firm.

In the case of a financial statement audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm, the network firm and the audit client, no safeguards could reduce the threat to an acceptable level. In the case of an assurance client that is not a financial statement audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm and the assurance client, no safeguards could reduce the threat to an acceptable level. Consequently, in both these circumstances the only possible courses of action are to:

- (a) Terminate the business relationship;
- (b) Reduce the magnitude of the relationship so that the financial interest is immaterial and the relationship is clearly insignificant; or
- (c) Refuse to perform the assurance engagement.

Unless any such financial interest is immaterial and the relationship is clearly insignificant to the member of the assurance team, the only appropriate safeguard would be to remove the individual from the assurance team.

8.131 In the case of a financial statement audit client, business relationships involving an interest held by the firm, a network firm or a member of the assurance team or their immediate family in a closely held entity when the audit client or a director or officer of the audit client, or any group thereof, also has an interest in that entity, do not create threats to independence provided:

- (a) The relationship is clearly insignificant to the firm, the network firm and the audit client;
- (b) The interest held is immaterial to the investor, or group of investors; and
- (c) The interest does not give the investor, or group of investors, the ability to control the closely held entity.

8.132 The purchase of goods and services from an assurance client by the firm (or from a financial statement audit client by a network firm) or a member of the assurance team would not generally create a threat to independence providing the transaction is in the normal course of business and on an arm's length basis. However, such transactions may

be of a nature or magnitude so as to create a self-interest threat. If the threat created is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Eliminating or reducing the magnitude of the transaction;
- Removing the individual from the assurance team; or
- Discussing the issue with those charged with governance, such as the audit committee.

### Family and Personal Relationships

8.133 Family and personal relationships between a member of the assurance team and a director, an officer or certain employees, depending on their role, of the assurance client, may create self-interest, familiarity or intimidation threats. It is impracticable to attempt to describe in detail the significance of the threats that such relationships may create. The significance will depend upon a number of factors including the individual's responsibilities on the assurance engagement, the closeness of the relationship and the role of the family member or other individual within the assurance client. Consequently, there is a wide spectrum of circumstances that will need to be evaluated and safeguards to be applied to reduce the threat to an acceptable level.

8.134 ~~8.134~~—When an immediate family member of a member of the assurance team is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement, or was in such a position during any period covered by the engagement, the threats to independence can only be reduced to an acceptable level by removing the individual from the assurance team. The closeness of the relationship is such that no other safeguard could reduce the threat to independence to an acceptable level. If application of this safeguard is not used, the only course of action is to withdraw from the assurance engagement. For example, in the case of an audit of financial statements, if the spouse of a member of the assurance team is an employee in a position to exert direct and significant influence ~~over~~ the preparation of the audit client's accounting records or financial statements, the threat to independence could only be reduced to an acceptable level by removing the individual from the assurance team.

8.134a When an immediate family member of a member the assurance team is an employee in a position to exert direct and significant influence over the subject matter of the engagement, threats to independence may be created. The significance of the threats will depend on factors such as:

- The position the immediate family member holds with the client; and
- The role of the professional on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Removing the individual from the assurance team;
- Where possible, structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the immediate family member; or

- Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.

8.135 When a close family member of a member of the assurance team is a director, an officer, or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement, threats to independence may be created. The significance of the threats will depend on factors such as:

- The position the close family member holds with the client; and
- The role of the professional on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Removing the individual from the assurance team;
- Where possible, structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the close family member; or
- Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.

8.136 In addition, self-interest, familiarity or intimidation threats may be created when a person who is other than an immediate or close family member of a member of the assurance team has a close relationship with the member of the assurance team and is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement. Therefore, members of the assurance team are responsible for identifying any such persons and for consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship and the role of the individual within the assurance client.

8.137 Consideration should be given to whether self-interest, familiarity or intimidation threats may be created by a personal or family relationship between a partner or employee of the firm who is not a member of the assurance team and a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement. Therefore partners and employees of the firm are responsible for identifying any such relationships and for consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship, the interaction of the firm professional with the assurance team, the position held within the firm, and the role of the individual within the assurance client.

8.138 An inadvertent violation of this section as it relates to family and personal relationships would not impair the independence of a firm or a member of the assurance team when:

- (a) The firm has established policies and procedures that require all professionals to report promptly to the firm any breaches resulting from changes in the employment

status of their immediate or close family members or other personal relationships that create threats to independence;

- (b) Either the responsibilities of the assurance team are re-structured so that the professional does not deal with matters that are within the responsibility of the person with whom he or she is related or has a personal relationship, or, if this is not possible, the firm promptly removes the professional from the assurance engagement; and
- (c) Additional care is given to reviewing the work of the professional.

8.139 When an inadvertent violation of this section relating to family and personal relationships has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:

- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or
- Excluding the individual from any substantive decision-making concerning the assurance engagement.

### **Employment with Assurance Clients**

8.140 A firm or a member of the assurance team's independence may be threatened if a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement has been a member of the assurance team or partner of the firm. Such circumstances may create self-interest, familiarity and intimidation threats particularly when significant connections remain between the individual and his or her former firm. Similarly, a member of the assurance team's independence may be threatened when an individual participates in the assurance engagement knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future.

8.141 If a member of the assurance team, partner or former partner of the firm has joined the assurance client, the significance of the self-interest, familiarity or intimidation threats created will depend upon the following factors:

- (a) The position the individual has taken at the assurance client.
- (b) The amount of any involvement the individual will have with the assurance team.
- (c) The length of time that has passed since the individual was a member of the assurance team or firm.
- (d) The former position of the individual within the assurance team or firm.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Considering the appropriateness or necessity of modifying the assurance plan for the assurance engagement;
- Assigning an assurance team to the subsequent assurance engagement that is of sufficient experience in relation to the individual who has joined the assurance client;

- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary; or
- Quality control review of the assurance engagement.

In all cases, all of the following safeguards are necessary to reduce the threat to an acceptable level:

- (a) The individual concerned is not entitled to any benefits or payments from the firm unless these are made in accordance with fixed pre-determined arrangements. In addition, any amount owed to the individual should not be of such significance to threaten the firm's independence.
- (b) The individual does not continue to participate or appear to participate in the firm's business or professional activities.

8.142 A self-interest threat is created when a member of the assurance team participates in the assurance engagement while knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future. This threat can be reduced to an acceptable level by the application of all of the following safeguards:

- (a) Policies and procedures to require the individual to notify the firm when entering serious employment negotiations with the assurance client.
- (b) Removal of the individual from the assurance engagement.

In addition, consideration should be given to performing an independent review of any significant judgments made by that individual while on the engagement.

#### **Recent Service with Assurance Clients**

8.143 To have a former officer, director or employee of the assurance client serve as a member of the assurance team may create self-interest, self-review and familiarity threats. This would be particularly true when a member of the assurance team has to report on, for example, subject matter information he or she had prepared or elements of the financial statements he or she had valued while with the assurance client.

8.144 If, during the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter information of the assurance engagement, the threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, such individuals should not be assigned to the assurance team.

8.145 If, prior to the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter information of the assurance engagement, this may create self-interest, self-review and familiarity threats. For example, such threats would be created if a decision made or work performed by the individual in the prior period, while employed by the assurance client, is to be evaluated in the current period as part of the current assurance engagement. The significance of the threats will depend upon factors such as:

- The position the individual held with the assurance client;
- The length of time that has passed since the individual left the assurance client; and

- The role the individual plays on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Involving an additional professional accountant to review the work done by the individual as part of the assurance team or otherwise advise as necessary; or
- Discussing the issue with those charged with governance, such as the audit committee.

### **Serving as an Officer or Director on the Board of Assurance Clients**

- 8.146 If a partner or employee of the firm serves as an officer or as a director on the board of an assurance client the self-review and self-interest threats created would be so significant no safeguard could reduce the threats to an acceptable level. In the case of a financial statement audit engagement, if a partner or employee of a network firm were to serve as an officer or as a director on the board of the audit client the threats created would be so significant no safeguard could reduce the threats to an acceptable level. Consequently, if such an individual were to accept such a position the only course of action is to refuse to perform, or to withdraw from the assurance engagement.
- 8.147 The position of Company Secretary has different implications in different jurisdictions. The duties may range from administrative duties such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally this position is seen to imply a close degree of association with the entity and may create self-review and advocacy threats.
- 8.148 If a partner or employee of the firm or a network firm serves as Company Secretary for a financial statement audit client the self-review and advocacy threats created would generally be so significant, no safeguard could reduce the threat to an acceptable level. When the practice is specifically permitted under local law, professional rules or practice, the duties and functions undertaken should be limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns.
- 8.149 Routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters is generally not perceived to impair independence, provided client management makes all relevant decisions.

### **Long Association of Senior Personnel With Assurance Clients**

#### *General Provisions*

- 8.150 Using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threat. The significance of the threat will depend upon factors such as:
- The length of time that the individual has been a member of the assurance team;
  - The role of the individual on the assurance team;
  - The structure of the firm; and
  - The nature of the assurance engagement.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied to reduce the threat to an acceptable level. Such safeguards might include:

- Rotating the senior personnel off the assurance team;
- Involving an additional professional accountant who was not a member of the assurance team to review the work done by the senior personnel or otherwise advise as necessary; or
- Independent internal quality reviews.

*Financial Statement Audit Clients That are Listed Entities*<sup>3</sup>

8.151 Using the same lead engagement partner or the same individual responsible for the engagement quality control review on a financial statement audit over a prolonged period may create a familiarity threat. This threat is particularly relevant in the context of the financial statement audit of a listed entity~~ies~~ and safeguards should be applied in such situations to reduce such threat to an acceptable level. Accordingly ~~for~~ in respect of the financial statement audit of listed entities:

- (a) The ~~lead~~-engagement partner and the individual responsible for the engagement quality control review should be rotated after serving in either capacity, or a combination thereof, for a pre-defined period, normally no more than seven years; and
- (b) ~~A partner~~Such an individual rotating after a pre-defined period should not participate in the audit engagement ~~resume the lead engagement partner role~~ until a further period of time, normally two years, has elapsed.

8.152 When a financial statement audit client becomes a listed entity the length of time the ~~lead~~-engagement partner has served the audit client in that capacity should be considered in determining when the partner should be rotated. However, the partner may continue to serve as the ~~lead~~-engagement partner for two additional years before rotating off the engagement.

8.153 While the ~~lead~~-engagement partner should be rotated after such a pre-defined period, some degree of flexibility over timing of rotation may be necessary in certain circumstances. Examples of such circumstances include:

- Situations when the ~~lead~~-engagement partner's continuity is especially important to the financial statement audit client, for example, when there will be major changes to the audit client's structure that would otherwise coincide with the rotation of the ~~lead~~ engagement partner; and
- Situations when, due to the size of the firm, rotation is not possible or does not constitute an appropriate safeguard.

In all such circumstances when the ~~lead~~-engagement partner is not rotated after such a pre-defined period equivalent safeguards should be applied to reduce any threats to an acceptable level.

8.154 When a firm has only a few audit partners with the necessary knowledge and experience to serve as ~~lead~~-engagement partner on a financial statement audit client that is a listed

<sup>3</sup> See also Interpretation 2003-02 on page 84.

entity, rotation of the lead partner may not be an appropriate safeguard. In these circumstances the firm should apply other safeguards to reduce the threat to an acceptable level. Such safeguards would include involving an additional professional accountant who was not otherwise associated with the assurance team to review the work done or otherwise advise as necessary. This individual could be someone from outside the firm or someone within the firm who was not otherwise associated with the assurance team.

#### Provision of Non-assurance Services to Assurance Clients<sup>4</sup>

- 8.155 Firms have traditionally provided to their assurance clients a range of non-assurance services that are consistent with their skills and expertise. Assurance clients value the benefits that derive from having these firms, who have a good understanding of the business, bring their knowledge and skill to bear in other areas. Furthermore, the provision of such non-assurance services will often result in the assurance team obtaining information regarding the assurance client's business and operations that is helpful in relation to the assurance engagement. The greater the knowledge of the assurance client's business, the better the assurance team will understand the assurance client's procedures and controls, and the business and financial risks that it faces. The provision of non-assurance services may, however, create threats to the independence of the firm, a network firm or the members of the assurance team, particularly with respect to perceived threats to independence. Consequently, it is necessary to evaluate the significance of any threat created by the provision of such services. In some cases it may be possible to eliminate or reduce the threat created by application of safeguards. In other cases no safeguards are available to reduce the threat to an acceptable level.
- 8.156 The following activities would generally create self-interest or self-review threats that are so significant that only avoidance of the activity or refusal to perform the assurance engagement would reduce the threats to an acceptable level:
- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of the assurance client, or having the authority to do so.
  - Determining which recommendation of the firm should be implemented.
  - Reporting, in a management role, to those charged with governance.
- 8.157 The examples set out in paragraphs 8.163 through 8.202 are addressed in the context of the provision of non-assurance services to an assurance client. The potential threats to independence will most frequently arise when a non-assurance service is provided to a financial statement audit client. The financial statements of an entity provide financial information about a broad range of transactions and events that have affected the entity. The subject matter information of other assurance services, however, may be limited in nature. Threats to independence, however, may also arise when a firm provides a non-assurance service related to the subject matter information of a non-financial statement audit assurance engagement. In such cases, consideration should be given to the significance of the firm's involvement with the subject matter information of the ~~non-audit assurance~~ engagement, whether any self-review threats are created and whether any threats to independence could be reduced to an acceptable level by application of safeguards, or whether the ~~non-assurance~~ engagement should be declined. When the non-assurance service is not related to the subject matter information of the non-financial

<sup>4</sup> See also Interpretation 2003-01 on page 84.

statement audit assurance engagement, the threats to independence will generally be clearly insignificant.

8.158 The following activities may also create self-review or self-interest threats:

- Having custody of an assurance client's assets.
- Supervising assurance client employees in the performance of their normal recurring activities.
- Preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction (for example, purchase orders, payroll time records, and customer orders).

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Making arrangements so that personnel providing such services do not participate in the assurance engagement;
- Involving an additional professional accountant to advise on the potential impact of the activities on the independence of the firm and the assurance team; or
- Other relevant safeguards set out in national regulations.

8.159 New developments in business, the evolution of financial markets, rapid changes in information technology, and the consequences for management and control, make it impossible to draw up an all-inclusive list of all situations when providing non-assurance services to an assurance client might create threats to independence and of the different safeguards that might eliminate these threats or reduce them to an acceptable level. In general, however, a firm may provide services beyond the assurance engagement provided any threats to independence have been reduced to an acceptable level.

8.160 The following safeguards may be particularly relevant in reducing to an acceptable level threats created by the provision of non-assurance services to assurance clients:

- Policies and procedures to prohibit professional staff from making management decisions for the assurance client, or assuming responsibility for such decisions.
- Discussing independence issues related to the provision of non-assurance services with those charged with governance, such as the audit committee.
- Policies within the assurance client regarding the oversight responsibility for provision of non-assurance services by the firm.
- Involving an additional professional accountant to advise on the potential impact of the non-assurance engagement on the independence of the member of the assurance team and the firm.
- Involving an additional professional accountant outside of the firm to provide assurance on a discrete aspect of the assurance engagement.
- Obtaining the assurance client's acknowledgement of responsibility for the results of the work performed by the firm.
- Disclosing to those charged with governance, such as the audit committee, the nature and extent of fees charged.

- Making arrangements so that personnel providing non-assurance services do not participate in the assurance engagement.
- 8.161 Before the firm accepts an engagement to provide a non-assurance service to an assurance client, consideration should be given to whether the provision of such a service would create a threat to independence. In situations when a threat created is other than clearly insignificant, the non-assurance engagement should be declined unless appropriate safeguards can be applied to eliminate the threat or reduce it to an acceptable level.
- 8.162 The provision of certain non-assurance services to financial statement audit clients may create threats to independence so significant that no safeguard could eliminate the threat or reduce it to an acceptable level. However, the provision of such services to a related entity, division or discrete financial statement item of such clients may be permissible when any threats to the firm's independence have been reduced to an acceptable level by arrangements for that related entity, division or discrete financial statement item to be audited by another firm or when another firm re-performs the non-assurance service to the extent necessary to enable it to take responsibility for that service.

*Preparing Accounting Records and Financial Statements*

- 8.163 Assisting an financial statement audit client in matters such as preparing accounting records or financial statements may create a self-review threat when the financial statements are subsequently audited by the firm.
- 8.164 It is the responsibility of financial statement audit client management to ensure that accounting records are kept and financial statements are prepared, although they may request the firm to provide assistance. If firm, or network firm, personnel providing such assistance make management decisions, the self-review threat created could not be reduced to an acceptable level by any safeguards. Consequently, personnel should not make such decisions. Examples of such managerial decisions include:
- Determining or changing journal entries, or the classifications for accounts or transaction or other accounting records without obtaining the approval of the audit client;
  - Authorizing or approving transactions; and
  - Preparing source documents or originating data (including decisions on valuation assumptions), or making changes to such documents or data.
- 8.165 The audit process involves extensive dialogue between the firm and management of the financial statement audit client. During this process, management requests and receives significant input regarding such matters as accounting principles and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. Technical assistance of this nature and advice on accounting principles for financial statement audit clients are an appropriate means to promote the fair presentation of the financial statements. The provision of such advice does not generally threaten the firm's independence. Similarly, the audit process may involve assisting an audit client in resolving account reconciliation problems, analyzing and accumulating information for regulatory reporting, assisting in the preparation of consolidated financial statements (including the translation of local statutory accounts to comply with group accounting policies and the transition to a different reporting framework such as International Financial Reporting Standards), drafting disclosure

items, proposing adjusting journal entries and providing assistance and advice in the preparation of local statutory accounts of subsidiary entities. These services are considered to be a normal part of the audit process and do not, under normal circumstances, threaten independence.

#### General Provisions

8.166 The examples in paragraphs 8.167 through 8.170 indicate that self-review threats may be created if the firm is involved in the preparation of accounting records or financial statements and those financial statements are subsequently the subject matter information of an audit engagement of the firm. This notion may be equally applicable in situations when the subject matter information of the assurance engagement is not financial statements. For example, a self-review threat would be created if the firm developed and prepared prospective financial information and subsequently provided assurance on this prospective financial information. Consequently, the firm should evaluate the significance of any self-review threat created by the provision of such services. If the self-review threat is other than clearly insignificant safeguards should be considered and applied as necessary to reduce the threat to an acceptable level.

#### Financial Statements Audit Clients That are Not Listed Entities

8.167 The firm, or a network firm, may provide a financial statement audit client that is not a listed entity with accounting and bookkeeping services, including payroll services, of a routine or mechanical nature, provided any self-review threat created is reduced to an acceptable level. Examples of such services include:

- Recording transactions for which the audit client has determined or approved the appropriate account classification;
- Posting coded transactions to the audit client's general ledger;
- Preparing financial statements based on information in the trial balance; and
- Posting the audit client approved entries to the trial balance.

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Making arrangements so such services are not performed by a member of the assurance team;
- Implementing policies and procedures to prohibit the individual providing such services from making any managerial decisions on behalf of the audit client;
- Requiring the source data for the accounting entries to be originated by the audit client;
- Requiring the underlying assumptions to be originated and approved by the audit client; or
- Obtaining audit client approval for any proposed journal entries or other changes affecting the financial statements.

Financial Statement Audit Clients That are Listed Entities

8.168 The provision of accounting and bookkeeping services, including payroll services and the preparation of financial statements or financial information which forms the basis of the financial statements on which the audit report is provided, on behalf of a financial statement audit client that is a listed entity, may impair the independence of the firm or network firm, or at least give the appearance of impairing independence. Accordingly, no safeguard other than the prohibition of such services, except in emergency situations and when the services fall within the statutory audit mandate, could reduce the threat created to an acceptable level. Therefore, a firm or a network firm should not, with the limited exceptions below, provide such services to listed entities which are financial statement audit clients.

8.169 The provision of accounting and bookkeeping services of a routine or mechanical nature to divisions or subsidiaries of ~~listed~~ a financial statement audit clients that is a listed entity would not be seen as impairing independence with respect to the audit client provided that the following conditions are met:

- (a) The services do not involve the exercise of judgment.
- (b) The divisions or subsidiaries for which the service is provided are collectively immaterial to the audit client, or the services provided are collectively immaterial to the division or subsidiary.
- (c) The fees to the firm, or network firm, from such services are collectively clearly insignificant.

If such services are provided, all of the following safeguards should be applied:

- (a) The firm, or network firm, should not assume any managerial role nor make any managerial decisions.
- (b) The ~~listed~~ audit client should accept responsibility for the results of the work.
- (c) Personnel providing the services should not participate in the audit.

Emergency Situations

8.170 The provision of accounting and bookkeeping services to financial statement audit clients in emergency or other unusual situations, when it is impractical for the audit client to make other arrangements, would not be considered to pose an unacceptable threat to independence provided:

- (a) The firm, or network firm, does not assume any managerial role or make any managerial decisions;
- (b) The audit client accepts responsibility for the results of the work; and
- (c) Personnel providing the services are not members of the assurance team.

*Valuation Services*

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

- 8.172 A self-review threat may be created when a firm or network firm performs a valuation for a financial statement audit client that is to be incorporated into the client's financial statements.
- 8.173 If the valuation service involves the valuation of matters material to the financial statements and the valuation involves a significant degree of subjectivity, the self-review threat created could not be reduced to an acceptable level by the application of any safeguard. Accordingly, such valuation services should not be provided or, alternatively, the only course of action would be to withdraw from the financial statement audit engagement.
- 8.174 Performing valuation services for a financial statement audit client that are neither separately, nor in the aggregate, material to the financial statements, or that do not involve a significant degree of subjectivity, may create a self-review threat that could be reduced to an acceptable level by the application of safeguards. Such safeguards might include:
- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary;
  - Confirming with the audit client their understanding of the underlying assumptions of the valuation and the methodology to be used and obtaining approval for their use;
  - Obtaining the audit client's acknowledgement of responsibility for the results of the work performed by the firm; and
  - Making arrangements so that personnel providing such services do not participate in the audit engagement.

In determining whether the above safeguards would be effective, consideration should be given to the following matters:

- (a) The extent of the audit client's knowledge, experience and ability to evaluate the issues concerned, and the extent of their involvement in determining and approving significant matters of judgment.
  - (b) The degree to which established methodologies and professional guidelines are applied when performing a particular valuation service.
  - (c) For valuations involving standard or established methodologies, the degree of subjectivity inherent in the item concerned.
  - (d) The reliability and extent of the underlying data.
  - (e) The degree of dependence on future events of a nature which could create significant volatility inherent in the amounts involved.
  - (f) The extent and clarity of the disclosures in the financial statements.
- 8.175 When a firm, or a network firm, performs a valuation service for a financial statement audit client for the purposes of making a filing or return to a tax authority, computing an amount of tax due by the ~~assurance~~ client, or for the purpose of tax planning, this would not create a significant threat to independence because such valuations are generally subject to external review, for example by a tax authority.
- 8.176 When the firm performs a valuation that forms part of the subject matter information of an assurance engagement that is not a financial statement audit engagement, the firm should consider any self-review threats. If the threat is other than clearly insignificant,

safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

*Provision of Taxation Services to Financial Statement Audit Clients*

8.177 In many jurisdictions, the firm may be asked to provide taxation services to a financial statement audit client. Taxation services comprise a broad range of services, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes. Such assignments are generally not seen to create threats to independence.

*Provision of Internal Audit Services to Financial Statement Audit Clients*

8.178 A self-review threat may be created when a firm, or network firm, provides internal audit services to a financial statement audit client. Internal audit services may comprise an extension of the firm's audit service beyond requirements of generally accepted auditing standards, assistance in the performance of a client's internal audit activities or outsourcing of the activities. In evaluating any threats to independence, the nature of the service will need to be considered. For this purpose, internal audit services do not include operational internal audit services unrelated to the internal accounting controls, financial systems or financial statements.

8.179 Services involving an extension of the procedures required to conduct a financial statement audit in accordance with International Standards on Auditing would not be considered to impair independence with respect to ~~an~~ the audit client provided that the firm's or network firm's personnel do not act or appear to act in a capacity equivalent to a member of audit client management.

8.180 When the firm, or a network firm, provides assistance in the performance of a client's internal audit activities or undertakes the outsourcing of some of the activities, any self-review threat created may be reduced to an acceptable level by ensuring that there is a clear separation between the management and control of the internal audit by audit client management and the internal audit activities themselves.

8.181 Performing a significant portion of the financial statement audit client's internal audit activities may create a self-review threat and a firm, or network firm, should consider the threats and proceed with caution before taking on such activities. Appropriate safeguards should be put in place and the firm, or network firm, should, in particular, ensure that the audit client acknowledges its responsibilities for establishing, maintaining and monitoring the system of internal controls.

8.182 Safeguards that should be applied in all circumstances to reduce any threats created to an acceptable level include ensuring that:

- (a) The audit client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the system of internal controls;
- (b) The audit client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;
- (c) The audit client, the audit committee or supervisory body approves the scope, risk and frequency of internal audit work;

- (d) The audit client is responsible for evaluating and determining which recommendations of the firm should be implemented;
  - (e) The audit client evaluates the adequacy of the internal audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining and acting on reports from the firm; and
  - (f) The findings and recommendations resulting from the internal audit activities are reported appropriately to the audit committee or supervisory body.
- 8.183 Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the financial statement audit engagement and with different reporting lines within the firm.

*Provision of IT Systems Services to Financial Statement Audit Clients*

- 8.184 The provision of services by a firm or network firm to a financial statement audit client that involve the design and implementation of financial information technology systems that are used to generate information forming part of a client's financial statements may create a self-review threat.
- 8.185 The self-review threat is likely to be too significant to allow the provision of such services to a financial statement audit client unless appropriate safeguards are put in place ensuring that:
- (a) The audit client acknowledges its responsibility for establishing and monitoring a system of internal controls;
  - (b) The audit client designates a competent employee, preferably within senior management, with the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system;
  - (c) The audit client makes all management decisions with respect to the design and implementation process;
  - (d) The audit client evaluates the adequacy and results of the design and implementation of the system; and
  - (e) The audit client is responsible for the operation of the system (hardware or software) and the data used or generated by the system.
- 8.186 Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the financial statement audit engagement and with different reporting lines within the firm.
- 8.187 The provision of services by a firm, or network firm, to a financial statement audit client which involve either the design or the implementation of financial information technology systems that are used to generate information forming part of a client's financial statements may also create a self-review threat. The significance of the threat, if any, should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.
- 8.188 The provision of services in connection with the assessment, design and implementation of internal accounting controls and risk management controls are not considered to create a threat to independence provided that firm or network firm personnel do not perform management functions.

*Temporary Staff Assignments to Financial Statement Audit Clients*

8.189 The lending of staff by a firm, or network firm, to a financial statement audit client may create a self-review threat when the individual is in a position to influence the preparation of a client's accounts or financial statements. In practice, such assistance may be given (particularly in emergency situations) but only on the understanding that the firm's or network firm's personnel will not be involved in:

- (a) Making management decisions;
- (b) Approving or signing agreements or other similar documents; or
- (c) Exercising discretionary authority to commit the client.

Each situation should be carefully analyzed to identify whether any threats are created and whether appropriate safeguards should be implemented. Safeguards that should be applied in all circumstances to reduce any threats to an acceptable level include:

- The staff providing the assistance should not be given audit responsibility for any function or activity that they performed or supervised during their temporary staff assignment; and
- The audit client should acknowledge its responsibility for directing and supervising the activities of firm, or network firm, personnel.

*Provision of Litigation Support Services to Financial Statement Audit Clients*

8.190 Litigation support services may include such activities as acting as an expert witness, calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute, and assistance with document management and retrieval in relation to a dispute or litigation.

8.191 A self-review threat may be created when the litigation support services provided to a financial statement audit client include the estimation of the possible outcome and thereby affects the amounts or disclosures to be reflected in the financial statements. The significance of any threat created will depend upon factors such as:

- The materiality of the amounts involved;
- The degree of subjectivity inherent in the matter concerned; and
- The nature of the engagement.

The firm, or network firm, should evaluate the significance of any threat created and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Policies and procedures to prohibit individuals assisting the audit client from making managerial decisions on behalf of the client;
- Using professionals who are not members of the assurance team to perform the service; or
- The involvement of others, such as independent experts.

8.192 If the role undertaken by the firm or network firm involved making managerial decisions on behalf of the financial statement audit client, the threats created could not be reduced

to an acceptable level by the application of any safeguard. Therefore, the firm or network firm should not perform this type of service for an audit client.

*Provision of Legal Services to Financial Statement Audit Clients*

- 8.193 Legal services are defined as any services for which the person providing the services must either be admitted to practice before the Courts of the jurisdiction in which such services are to be provided, or have the required legal training to practice law. Legal services encompass a wide and diversified range of areas including both corporate and commercial services to clients, such as contract support, litigation, mergers and acquisition advice and support and the provision of assistance to clients' internal legal departments. The provision of legal services by a firm, or network firm, to an entity that is an financial statement audit client may create both self-review and advocacy threats.
- 8.194 Threats to independence need to be considered depending on the nature of the service to be provided, whether the service provider is separate from the assurance team and the materiality of any matter in relation to the entities' financial statements. The safeguards set out in paragraph 8.160 may be appropriate in reducing any threats to independence to an acceptable level. In circumstances when the threat to independence cannot be reduced to an acceptable level the only available action is to decline to provide such services or withdraw from the financial statement audit engagement.
- 8.195 The provision of legal services to an financial statement audit client which involve matters that would not be expected to have a material effect on the financial statements are not considered to create an unacceptable threat to independence.
- 8.196 There is a distinction between advocacy and advice. Legal services to support an financial statement audit client in the execution of a transaction (e.g., contract support, legal advice, legal due diligence and restructuring) may create self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Such a service would not generally impair independence, provided that:
- (a) Members of the assurance team are not involved in providing the service; and
  - (b) In relation to the advice provided, the audit client makes the ultimate decision or, in relation to the transactions, the service involves the execution of what has been decided by the audit client.
- 8.197 Acting for an financial statement audit client in the resolution of a dispute or litigation in such circumstances when the amounts involved are material in relation to the financial statements of the audit client would create advocacy and self-review threats so significant no safeguard could reduce the threat to an acceptable level. Therefore, the firm should not perform this type of service for an financial statement audit client.
- 8.198 When a firm is asked to act in an advocacy role for an financial statement audit client in the resolution of a dispute or litigation in circumstances when the amounts involved are not material to the financial statements of the audit client, the firm should evaluate the significance of any advocacy and self-review threats created and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:
- Policies and procedures to prohibit individuals assisting the audit client from making managerial decisions on behalf of the client; or

- Using professionals who are not members of the assurance team to perform the service.
- 8.199 The appointment of a partner or an employee of the firm or network firm as General Counsel for legal affairs to an financial statement audit client would create self-review and advocacy threats that are so significant no safeguards could reduce the threats to an acceptable level. The position of General Counsel is generally a senior management position with broad responsibility for the legal affairs of a company and consequently, no member of the firm or network firm should accept such an appointment for an financial statement audit client.

*Recruiting Senior Management*

- 8.200 The recruitment of senior management for an assurance client, such as those in a position to affect the subject matter information of the assurance engagement, may create current or future self-interest, familiarity and intimidation threats. The significance of the threat will depend upon factors such as:

- The role of the person to be recruited; and
- The nature of the assistance sought.

The firm could generally provide such services as reviewing the professional qualifications of a number of applicants and provide advice on their suitability for the post. In addition, the firm could generally produce a short-list of candidates for interview, provided it has been drawn up using criteria specified by the assurance client.

The significance of the threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. In all cases, the firm should not make management decisions and the decision as to whom to hire should be left to the client.

*Corporate Finance and Similar Activities*

- 8.201 The provision of corporate finance services, advice or assistance to an assurance client may create advocacy and self-review threats. In the case of certain corporate finance services, the independence threats created would be so significant no safeguards could be applied to reduce the threats to an acceptable level. For example, promoting, dealing in, or underwriting of an assurance client's shares is not compatible with providing assurance services. Moreover, committing the assurance client to the terms of a transaction or consummating a transaction on behalf of the client would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level. In the case of an audit client the provision of those corporate finance services referred to above by a firm or a network firm would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level.

- 8.202 Other corporate finance services may create advocacy or self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Examples of such services include assisting a client in developing corporate strategies, assisting in identifying or introducing a client to possible sources of capital that meet the client specifications or criteria, and providing structuring advice and assisting a client in analyzing the accounting effects of proposed transactions. Safeguards that should be considered include:

- Policies and procedures to prohibit individuals assisting the assurance client from making managerial decisions on behalf of the client;
- Using professionals who are not members of the assurance team to provide the services; and
- Ensuring the firm does not commit the assurance client to the terms of any transaction or consummate a transaction on behalf of the client.

### **Fees and Pricing**

#### *Fees—Relative Size*

8.203 When the total fees generated by an assurance client represent a large proportion of a firm's total fees, the dependence on that client or client group and concern about the possibility of losing the client may create a self-interest threat. The significance of the threat will depend upon factors such as:

- The structure of the firm; and
- Whether the firm is well established or newly created.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Discussing the extent and nature of fees charged with the audit committee, or others charged with governance;
- Taking steps to reduce dependency on the client;
- External quality control reviews; and
- Consulting a third party, such as a professional regulatory body or another professional accountant.

8.204 A self-interest threat may also be created when the fees generated by the assurance client represent a large proportion of the revenue of an individual partner. The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Policies and procedures to monitor and implement quality control of assurance engagements; and
- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary.

#### *Fees—Overdue*

8.205 A self-interest threat may be created if fees due from an assurance client for professional services remain unpaid for a long time, especially if a significant part is not paid before the issue of the assurance report for the following year. Generally the payment of such fees should be required before the report is issued. The following safeguards may be applicable:

- Discussing the level of outstanding fees with the audit committee, or others charged with governance.

- Involving an additional professional accountant who did not take part in the assurance engagement to provide advice or review the work performed.

The firm should also consider whether the overdue fees might be regarded as being equivalent to a loan to the client and whether, because of the significance of the overdue fees, it is appropriate for the firm to be re-appointed.

#### *Pricing*

- 8.206 When a firm obtains an assurance engagement at a significantly lower fee level than that charged by the predecessor firm, or quoted by other firms, the self-interest threat created will not be reduced to an acceptable level unless:
- (a) The firm is able to demonstrate that appropriate time and qualified staff are assigned to the task; and
  - (b) All applicable assurance standards, guidelines and quality control procedures are being complied with.

#### *Contingent Fees*

- 8.207 Contingent fees are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed. For the purposes of this section, fees are not regarded as being contingent if a court or other public authority has established them.
- 8.208 A contingent fee charged by a firm in respect of an assurance engagement creates self-interest and advocacy threats that cannot be reduced to an acceptable level by the application of any safeguard. Accordingly, a firm should not enter into any fee arrangement for an assurance engagement under which the amount of the fee is contingent on the result of the assurance work or on items that are the subject matter [information](#) of the assurance engagement.
- 8.209 A contingent fee charged by a firm in respect of a non-assurance service provided to an assurance client may also create self-interest and advocacy threats. If the amount of the fee for a non-assurance engagement was agreed to, or contemplated, during an assurance engagement and was contingent on the result of that assurance engagement, the threats could not be reduced to an acceptable level by the application of any safeguard. Accordingly, the only acceptable action is not to accept such arrangements. For other types of contingent fee arrangements, the significance of the threats created will depend on factors such as:
- The range of possible fee amounts;
  - The degree of variability;
  - The basis on which the fee is to be determined;
  - Whether the outcome or result of the transaction is to be reviewed by an independent third party; and
  - The effect of the event or transaction on the assurance engagement.

The significance of the threats should be evaluated and, if the threats are other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threats to an acceptable level. Such safeguards might include:

- Disclosing to the audit committee, or others charged with governance, the extent and nature of fees charged;
- Review or determination of the final fee by an unrelated third party; or
- Quality and control policies and procedures.

### **Gifts and Hospitality**

8.210 Accepting gifts or hospitality from an assurance client may create self-interest and familiarity threats. When a firm or a member of the assurance team accepts gifts or hospitality, unless the value is clearly insignificant, the threats to independence cannot be reduced to an acceptable level by the application of any safeguard. Consequently, a firm or a member of the assurance team should not accept such gifts or hospitality.

### **Actual or Threatened Litigation**

8.211 When litigation takes place, or appears likely, between the firm or a member of the assurance team and the assurance client, a self-interest or intimidation threat may be created. The relationship between client management and the members of the assurance team must be characterized by complete candor and full disclosure regarding all aspects of a client's business operations. The firm and the client's management may be placed in adversarial positions by litigation, affecting management's willingness to make complete disclosures and the firm may face a self-interest threat. The significance of the threat created will depend upon such factors as:

- The materiality of the litigation;
- The nature of the assurance engagement; and
- Whether the litigation relates to a prior assurance engagement.

Once the significance of the threat has been evaluated the following safeguards should be applied, if necessary, to reduce the threats to an acceptable level:

- (a) Disclosing to the audit committee, or others charged with governance, the extent and nature of the litigation;
- (b) If the litigation involves a member of the assurance team, removing that individual from the assurance team; or
- (c) Involving an additional professional accountant in the firm who was not a member of the assurance team to review the work done or otherwise advise as necessary.

If such safeguards do not reduce the threat to an appropriate level, the only appropriate action is to withdraw from, or refuse to accept, the assurance engagement.