

REVISION OF SECTION 290

INDEPENDENCE – AUDIT AND REVIEW ENGAGEMENTS

Internal Audit Services

- 290.186 The scope and objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance. Internal audit activities may include one or more of the following:
- (a) Monitoring of internal control – reviewing controls, monitoring their operation and recommending improvements thereto;
 - (b) Examination of financial and operating information – reviewing the means used to identify, measure, classify and report financial and operating information, and specific inquiry into individual items including detailed testing of transactions, balances and procedures;
 - (c) Review of the economy, efficiency and effectiveness of operating activities including non-financial activities of an entity; and
 - (d) Review of compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.
- 290.187 Internal audit services involve assisting the audit client in the performance of its internal audit activities. The provision of internal audit services to an audit client may create a self-review threat to independence if the firm intends to use the internal audit work in the course of a subsequent external audit. Furthermore, if the firm assumes a management responsibility when providing an internal audit service to an audit client, the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm should ensure that it does not assume a management responsibility when providing internal audit services to an audit client.
- 290.188 Assisting an audit client in the performance of a significant part of the client's internal audit function increases the risk that firm personnel providing the internal audit service will assume a management responsibility.
- 290.189 Examples of internal audit services that involve assuming management responsibilities include:
- (a) Setting internal audit policies or the strategic direction of internal audit activities;
 - (b) Directing and taking responsibility for the actions of the entity's internal audit employees;
 - (c) Deciding which recommendations resulting from internal audit activities should be implemented;
 - (d) Reporting the results of the internal audit activities to those charged with governance on behalf of management;

- (e) Performing procedures that form part of the internal control, such as reviewing and approving changes to employee data access privileges;
- (f) Taking responsibility for designing, implementing and maintaining internal control; and
- (g) Performing outsourced internal audit services, comprising all or a substantial portion of the internal audit function, where the firm is responsible for determining the scope of the internal audit work and may have responsibility for one or more of the matters noted in (a) – (f).

290.190 To ensure that, in performing internal audit services, the firm does not assume a management responsibility, the firm should only provide internal audit services to an audit client if all of the following conditions are met:

- (a) The client designates an appropriate and competent resource, preferably within senior management, to be responsible for internal audit activities and to acknowledge responsibility for designing, implementing, and maintaining internal control;
- (b) The client's management or those charged with governance reviews, assesses and approves the scope, risk and frequency of internal audit work;
- (c) The client's management evaluates the adequacy of the internal audit procedures and the findings resulting from their performance;
- (d) The client's management evaluates and determines which recommendations resulting from internal audit activities to implement and manages the implementation process; and
- (e) The client's management reports to those charged with governance the significant findings and recommendations resulting from the internal audit activities.

290.191 When a firm uses the work of an internal audit function, international auditing standards require the performance of procedures to evaluate the adequacy of that work. This comprises an evaluation of whether:

- (a) The work was performed by individuals having appropriate skills and expertise;
- (b) The work was properly supervised, reviewed and documented;
- (c) Sufficient appropriate audit evidence was obtained to enable the individuals who performed the internal audit work to draw reasonable conclusions;
- (d) Conclusions reached were appropriate in the circumstances and any reports prepared are consistent with the results of the work performed; and
- (e) Any exceptions or unusual matters disclosed by the internal audit function were properly resolved.

The nature, timing and extent of the procedures required to be performed under international auditing standards are matters of professional judgment depending on the

extent of the effect of the internal audit work on the external audit and may include one or a combination of the following:

- Re-performance of internal audit work;
- Examination of other similar items; or
- Observation of internal audit procedures.

290.192 When a firm accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the external audit, a self-review threat is created because of the risk that the audit team will use the results of the internal audit service without appropriately evaluating those results or exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm. Accordingly, when evaluating the adequacy of the internal audit work, the firm should perform procedures which are no less rigorous than the procedures required when the internal audit work is performed by individuals who are not members of the firm. If individuals who have performed internal audit services are subsequently members of the external audit team, they should not be given any audit responsibility for any internal audit function or activity with which they were involved as part of performing the internal audit services.

290.193 If the external audit procedures performed to evaluate the adequacy of the firm's internal audit services identify a deficiency in the internal audit services a self-interest threat may be created. That threat is similar to the threat that may be created when a deficiency in an external audit procedure is identified as a result of performing a subsequent external audit procedure. Accordingly, situations involving the discovery of a deficiency in the internal audit services should be addressed with the same commitment to the fundamental principles of the Code, particularly integrity and objectivity, as would be the case when addressing a deficiency in a previous external audit procedure. Firms should determine that individuals assigned to the external audit who will evaluate the adequacy of the firm's internal audit work have an appropriate level of expertise and stature within the firm to conduct such an evaluation effectively.

Fees

Fees – Relative Size

290.213 When the total fees from an audit client represent a large proportion of the total fees of the firm expressing the audit opinion, the dependence on that client and concern about losing the client may create a self-interest threat. The significance of the threat will depend on factors such as:

- The operating structure of the firm;
- Whether the firm is well established or new; and
- The significance of the client qualitatively and/or quantitatively to the firm.

The significance of the threat should be evaluated and, if the threat is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Taking steps to reduce the dependency on the audit client;
- External quality control reviews; or
- Consulting a third party, such as a professional regulatory body or another professional accountant, on key audit judgments.

290.214 A self-interest threat may also be created when the fees generated from an audit client represent a large proportion of the revenue from an individual partner's clients. The significance of the threat should be evaluated and, if the threat is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include having an additional professional accountant review the work or otherwise advise as necessary.

Audit Clients that are Entities of Significant Public Interest

290.215 In the case of an audit client that is an entity of significant public interest when, for two consecutive years, the total fees from the client and its related entities (subject to the considerations in paragraph 290.24) represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, the self-interest threat would be too significant unless the firm discloses to those charged with governance of the audit client the fact that the total of such fees represents more than 15% of the total fees received by the firm and discusses which of the safeguards below will be applied to reduce the threat to an acceptable level:

- After the audit opinion on the second year's financial statements has been issued, and before the issuance of the audit opinion on the third year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, or a professional regulatory body performs a review that is equivalent to an engagement quality control review ("a post-issuance review"); or
- Prior to the issuance of the audit opinion on the second year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, performs an engagement quality control review or a professional regulatory body performs a review that is equivalent to an engagement quality control review ("a pre-issuance review")

When the total fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review shall be performed.

Thereafter, when the fees continue to exceed 15%, each year the disclosure to and discussion with those charged with governance should occur and one of the above

safeguards should be applied. If the fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review shall be performed.

Fees – Overdue

290.216 A self-interest threat may be created if fees due from an audit client remain unpaid for a long time, especially if a significant part is not paid before the issue of the audit report for the following year. Generally the firm should require payment of such fees before the audit report is issued. If the fee remains unpaid after the report has been issued, the significance of the threat should be evaluated. If the threat is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include having an additional professional accountant who did not take part in the audit engagement, 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.

Contingent Fees

290.217 **Contingent fees*** are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the services performed by the firm. For the purposes of this section, fees are not regarded as being contingent if a court or other public authority has established them or is required to approve them.

290.218 A contingent fee charged by a firm in respect of an audit engagement creates self-interest and advocacy threats that cannot be reduced to an acceptable level by applying any safeguard. Accordingly, a firm should not enter into any such fee arrangement.

290.219 A contingent fee charged by a firm in respect of a non-assurance service provided to an audit client may also create self-interest and advocacy threats. No safeguards can reduce the threats to an acceptable level if either:

- (a) The fee is charged by the firm expressing the opinion on the financial statements and the fee is material or expected to be material to that firm;
- (b) The fee is charged by a network firm and the fee would be material to the firm expressing the opinion on the financial statements had that firm charged the fee; or
- (c) The outcome of the non-assurance service, and therefore the amount of the fee, is dependent upon a future or contemporary judgment related to the audit of a material amount in the financial statements.

Accordingly, such arrangements should not be accepted.

* See Definitions.

290.220 For other contingent fee arrangements charged by a firm for a non-assurance service to an audit client, the significance of the threats will depend on factors such as:

- The range of possible fee amounts;
- The nature of the service; and
- The effect of the event or transaction on the financial statements.

The significance of the threats should be evaluated and, if the threats are not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threats or reduce them to an acceptable level. Such safeguards might include:

- Having an additional professional accountant review the relevant audit work or otherwise advise as necessary;
- Determination by an appropriate authority of the outcome of the matter upon which the contingent fee will be determined.

REVISION OF SECTION 291

INDEPENDENCE – OTHER ASSURANCE ENGAGEMENTS

Contingent Fees

291.151 Contingent fees are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the services performed by the firm. For the purposes of this section, fees are not regarded as being contingent if a court or other public authority has established them or is required to approve them.

291.152 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 applying any safeguard. Accordingly, a firm should not enter into any such fee arrangement.

291.153 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 outcome of the non-assurance service, and therefore the amount of the fee, is dependent upon a future or contemporary judgment related to a matter that is material to subject matter information of the assurance engagement no safeguards can reduce the threat to an acceptable level. Accordingly, such arrangements should not be accepted.

291.154 For other types of contingent fee arrangements charged by a firm for a non-assurance service to an assurance client, the significance of the threats will depend on factors such as:

- The range of possible fee amounts;
- The nature of the service; and
- The effect of the event or transaction on the financial statements.

The significance of the threats should be evaluated and, if the threats are not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threats or reduce them to an acceptable level. Such safeguards might include:

- Having an additional professional accountant review the relevant assurance work or otherwise advise as necessary; or
- Determination by an appropriate authority of the outcome of the matter upon which the contingent fee will be determined.

Definitions

Contingent fee A fee calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm. A fee that is established or required to be approved by a court or other public authority is not a contingent fee.