

# Provisions in the IESBA Code of Ethics that apply to audits of Public Interest Entities

Draft for discussion

## **PURPOSE**

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This document has been prepared to facilitate a discussion of the independence provisions in the Code of Ethics that apply to the audits of public interest entities (PIEs)<sup>1</sup>. It is intended to be used in discussions with national standard setters and regulators with a view to seeking input on the types of improvements that they believe should be made to the Code to gain acceptance and recognition of the Code in their jurisdictions.

Two principal factors contribute to the robustness of the Code, and are highlighted in this document.

- ***Prohibitions*** - numerous provisions preclude accountants from entering into interests or relationships that the Board has concluded would impair independence.
- ***Conceptual framework*** - just because an interest or relationship is not prohibited doesn't mean it is permitted. In those cases, accountants must evaluate the significance of any threats to independence and apply safeguards when necessary to eliminate the threats or reduce them to an acceptable level,

A separate supporting document details the provisions in Part A relevant to independence and those in Section 290 of the Code. That document identifies which of those provisions are relevant to the audits of PIEs and provides a synopsis of the provision, which is included in this document. Thus, much of the detail in the Code has not been replicated in this document. For example, although mandatory safeguards are included, examples of possible safeguards have not.

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<sup>1</sup> PIEs are listed entities and any entity defined by regulation or legislation as a PIE or for which the audit is required to be conducted in compliance with the independence requirements applicable to audits of listed entities (see key terms in the Appendix).

## **PART 1 – OVERARCHING PROVISIONS**

### **Introduction**

A professional accountant is required to act in the public interest and comply with the Code [100.1].

The Code “prohibits” the professional accountant from entering into certain interests and relationships. For other interests and relationships, the Code provides a conceptual framework that the accountant is required to apply to (i) identify threats to independence; (ii) evaluate the significance of the threats, and (iii) apply safeguards, when necessary<sup>2</sup>, to eliminate the threats or reduce them to an acceptable level. [290.7].

A professional accountant is required to use professional judgment in applying the conceptual framework [100.7] and, when evaluating the significance of a threat, to take account of qualitative as well as quantitative factors. [100.9]

When the professional accountant determines that appropriate safeguards are not available or cannot be applied to eliminate the threats or reduce them to an acceptable level, the professional accountant shall eliminate the circumstance or relationship creating the threats or decline or terminate the audit engagement. [290.7]

The Code does not describe all of the circumstances and relationships that create or may create a threat to independence. In those situations, the firm and members of the audit team shall evaluate the circumstance or relationship using the conceptual framework.[290.100] Whenever new information about a threat to independence comes to the attention of the firm during the engagement, the firm shall evaluate the significance of the threat in accordance with the conceptual framework approach. [290.10]

When a professional accountant encounters unusual circumstances in which the application of a specific requirement of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest, it is recommended that the professional accountant consult with a member body or the relevant regulator. [100.11]

The Code does not, in most cases, prescribe the specific responsibility of individuals within the firm for actions related to independence because responsibility may differ depending on the size, structure and organization of a firm. [290.12]

### **Networks and Network Firms**

A network firm shall be independent of the audit clients of the other firms within the network. [290.13]

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<sup>2</sup> Safeguards are necessary when the professional accountant determines that the threats are not at a level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised. [100.2]

## **PART 1 – OVERARCHING PROVISIONS**

### **Related Entities**

In the case of an audit client that is a listed entity, references to an audit client include related entities of the client (unless otherwise stated). For all other audit clients, references to an audit client include related entities over which the client has direct or indirect control. When the audit team knows or has reason to believe that a relationship or circumstance involving another related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team shall include that related entity when identifying and evaluating threats to independence and applying appropriate safeguards. [290.27]

### **Those Charged with Governance**

Regular communication is encouraged between the firm and those charged with governance of the audit client regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence. [290.28]

### **Documentation**

The professional accountant shall document conclusions regarding compliance with independence requirements, and the substance of any relevant discussions that support those conclusions and

- When safeguards are required, the nature of the threat and the safeguards in place or applied that reduce the threat to an acceptable level.
- When a threat required significant analysis to determine whether safeguards were necessary and the professional accountant concluded that they were not because the threat was already at an acceptable level, the nature of the threat and the rationale for the conclusion. [290.29]

### **Engagement Period**

Independence is required both during the engagement period and the period covered by the financial statements<sup>3</sup>. [290.30]

### **Inadvertent Violations**

If an inadvertent violation occurs, it generally will be deemed not to compromise independence provided the firm has appropriate quality control policies and procedures in place, equivalent to those required by International Standards on Quality Control, to maintain independence and, once discovered, the violation is corrected promptly and any necessary safeguards are applied to eliminate any threat or reduce it to an acceptable level. The firm shall determine whether to discuss the matter with those charged with governance. [290.39]

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<sup>3</sup> The Code also includes provisions dealing with situations in which an entity becomes an audit client during or after the period covered by the financial statements on which the firm will express an opinion [290.31] and a non-assurance service was provided to the audit client during or after the period covered by the financial statements but before the audit team begins to perform audit services. [290.32]

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

### Financial Interests

#### *Prohibited*

A member of the audit team, a member of that individual's immediate family, and a firm shall not have:

- a direct or material indirect financial interest in an audit client. [290.104]
- a direct or material indirect financial interest in an entity that has a controlling interest in the audit client, where the client is material to the entity. [290.106]
- a financial interest in an entity, in which an audit client also has an interest, if such interest is material to any party, and the audit client can exercise significant influence over the other entity. [290.112]

Partners in the office in which the engagement partner practices in connection with the audit engagement, and partners and managerial employees who provide non-audit services to the audit client, except those whose involvement is minimal, and their immediate family members, shall not have a direct or a material indirect financial interest in that audit client. [290.108 and 290.110]

None of the above shall have a direct or material indirect financial interest in the audit client as a trustee if the interest is material to the trust [290.114].

#### *Permitted if certain conditions exist or specified safeguards are applied*

A financial interest received as a result of the employment rights of an immediate family member of a partner in the office in which the engagement partner practices or partners and managerial employees who provide non-audit services to the audit client is permitted if:

- Safeguards are applied, when necessary, to eliminate the related threat or reduce it to an acceptable level; and
- When the immediate family member has or obtains the right to dispose of the financial interest or exercise a stock option, the interest is disposed of or forfeited as soon as practicable. [290.111]

Members of the audit team, partners in the engagement office, partners and managerial employees who provide non-audit services to the audit client (as above), and their immediate family members, and the firm are permitted to have a direct or material indirect financial interest in the audit client as a trustee if the interest is immaterial to the trust and:

- Neither the trustee, nor an immediate family member of the trustee, nor the firm are beneficiaries of the trust or can significantly influence any investment decision involving a financial interest in the audit client; and
- The trust is not able to exercise significant influence over the audit client. [290.114]

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

### *Requires an analysis of threats and application of safeguards, when necessary*

- A member of the audit team knows that a close family member has a direct financial interest or a material indirect financial interest in the audit client [290.105]
- A firm's retirement benefit plan holds a direct or material indirect financial interest in an audit client [290.107]
- A member of the audit team, or a member of that individual's immediate family, or the firm, has a financial interest in an entity when a director, officer, or controlling owner of the audit client is also known to have a financial interest in that entity. [290.113]
- Members of the audit team know that financial interests in the audit client are held by other individuals including (i) partners and professional employees of the firm, other than those referred to above, or their immediate family members, (ii) individuals with a close personal relationship with a member of the audit team. [290.115]

### *Inadvertent violations*

An inadvertent violation of the Code relating to a financial interest in an audit client is deemed not to compromise independence (i) if the firm has established policies and procedures that require prompt notification of any breaches, (ii) actions are taken to address the violation (including disposal of the interest), and (iii) other safeguards are applied, when necessary, to reduce any remaining threat to an acceptable level. The firm shall determine whether to discuss the matter with those charged with governance. [290.117]

### **Loans and Guarantees**

#### *Prohibited*

A member of the audit team, and a member of that individual's immediate family, and the firm shall not:

- Have a loan, or a guarantee of a loan, from an audit client that is a bank or a similar institution that has not been made under normal lending procedures, terms and conditions. [290.118]
- Have a loan from an audit client that is not a bank or similar institution that is material to (a) the firm or the member of the audit team and the immediate family member, or (b) the client. [290.121]
- Make or guarantee a loan to an audit client that is material to (a) the firm or the member of the audit team and the immediate family member, or (b) the client. [290.122]
- Have a deposit or brokerage account with an audit client that is a bank, broker, or similar institution if the deposit or account is not held under normal commercial terms. [290.123]

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

### *Requires an analysis of threats and application of safeguards when necessary*

- When a loan to a firm, made under normal lending procedures, terms, and conditions, is material to either the firm or the audit client, it may be possible to apply safeguards to reduce the threat to an acceptable level. [290.119]

### **Business Relationships**

#### *Prohibited*

A firm and a member of the audit team shall not have a close business relationship with an audit client or its management if, in the case of the firm, any financial interest is material or the business relationship is significant to the firm or the client or its management and, in the case of the audit team member, any financial interest is material or the business relationship is significant to the member of the audit team. [290.124]

#### *Permitted if certain conditions exist or specified safeguards are applied*

A business relationship involving the holding of an interest by the firm, or a member of the audit team, or a member of that individual's immediate family, in a closely-held entity when the audit client or a director or officer of the client, or any group thereof, also holds an interest in that entity. [290.125]

### *Requires an analysis of threats and application of safeguards when necessary*

A business relationship between an immediate family member of a member of the audit team and an audit client or its management. [290.124]

The purchase of goods and services from an audit client by the firm, or a member of the audit team, or a member of that individual's immediate family, even if in the normal course of business and at arm's length, depending on the nature or magnitude. [290.126]

### **Family and Personal Relationships**

#### *Prohibited*

A member of the audit team shall not have an immediate family member who is a director or officer of the audit client, or an employee in a position to exert significant influence over the preparation of the client's accounting records or financial statements, or was in such a position during any period covered by the engagement or the financial statements. [290.128]

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

### *Requires an analysis of threats and application of safeguards, when necessary*

- (a) An immediate family member of a member of the audit team is an employee of the audit client in a position to exert significant influence over the client's financial position, financial performance, or cash flows. [290.129]
- (b) A close family member of a member of the audit team is a director or officer of the audit client, or an employee in a position to exert significant influence over the preparation of the client's accounting records or financial statements. [290.130]
- (c) A member of the audit team has a close relationship with a person who is not an immediate or close family member, but who is a director or officer of the audit client or an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements. [290.131]
- (d) There is a personal or family relationship between (a) a partner or employee of the firm who is not a member of the audit team and (b) a director or officer of the audit client or an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements. [290.132]

### *Inadvertent violations*

An inadvertent violation of the Code as it relates to family and personal relationships is deemed not to compromise independence (i) if the firm has established policies and procedures that require prompt notification of any breaches, (ii) where the violation relates to an immediate family member of a member of the audit team, the individual is removed from the audit team, and (iii) other safeguards are applied, when necessary, to reduce any remaining threat to an acceptable level. The firm shall determine whether to discuss the matter with those charged with governance. [290.133]

### **Employment with an Audit Client**

#### *Prohibited*

The following shall not join an audit client as a director or officer, or as an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements.

- A former member of the audit team or partner if significant connections remain with the firm. Accordingly, such an individual shall not be entitled to any benefits or payments from the firm, unless made in accordance with fixed pre-determined arrangements, and any amount owed to the individual shall not be material to the firm. The individual shall not continue to participate or appear to participate in the firm's business or professional activities. [290.135]
- A key audit partner, unless subsequent to the partner ceasing to be a key audit partner, the client had issued audited financial statements covering a period of not less than twelve months and the partner was not a member of the audit team with respect to the audit of those financial statements. [290.139]
- The firm's Senior or Managing Partner, unless twelve months have passed since the individual was the Senior or Managing Partner. [290.140]

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

### *Permitted if certain conditions exist or specified safeguards are applied*

A former key audit partner or the individual who was the firm's former Senior or Managing Partner is in a position described above as a result of a business combination if

- (a) The position was not taken in contemplation of the business combination;
- (b) Any benefits or payments due to the former partner from the firm have been settled in full, unless made in accordance with fixed pre-determined arrangements and any amount owed to the partner is not material to the firm;
- (c) The former partner does not continue to participate or appear to participate in the firm's business or professional activities; and
- (d) The position held by the former partner with the audit client is discussed with those charged with governance. [290.141]

### *Requires an analysis of threats and application of safeguards, when necessary*

- (a) A former member of the audit team or partner who has joined the audit client in a position described above has no significant connection remaining with the firm [290.136]
- (b) A former partner has previously joined an entity in such a position and the entity subsequently becomes an audit client of the firm [290.137]
- (c) A member of the audit team is considering joining the audit client (in such situations, firm policies and procedures shall require the individual to notify the firm). [290.138]

### **Temporary Staff Assignments**

#### *Permitted if certain conditions exist or specified safeguards are applied*

The firm may lend staff to an audit client for a short period of time if

- The staff will not be providing prohibited non-assurance services and will not assume management responsibilities;
- The audit client will be responsible for directing and supervising the activities of the staff; and
- The significance of any threat is evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. [290.142]

### **Recent Service with an Audit Client**

#### *Prohibited*

An individual who has served, during the period covered by the audit report, as a director or officer of the audit client, or was an employee in a position to exert significant influence over the preparation of the client's accounting records or financial statements shall not be a member of the audit team. [290.144]

#### *Requires an analysis of threats and application of safeguards, when necessary*

Before the period covered by the audit report, a member of the audit team had served as a director or officer of the audit client, or was an employee in a position to exert significant

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

influence over the preparation of the client’s accounting records or financial statements. [290.145]

### **Serving as a Director or Officer of an Audit Client**

#### ***Prohibited***

No partner or employee of the firm shall serve as a director or officer of an audit client. [290.146]

#### ***Permitted if certain conditions exist or specified safeguards are applied***

A partner or employee of the firm shall serve as Company Secretary for an audit client only if

- The practice is specifically permitted under local law, professional rules, or practice,
- Management makes all relevant decisions,
- The duties and activities of the individual are limited to those of a routine and administrative nature, and
- The significance of any threats are evaluated and safeguards are applied when necessary. [290.148]

Performing routine administrative services to support a company secretarial function or providing advice in relation to company secretarial administration matters, if client management makes all relevant decisions. [290.149]

### **Long Association of Senior Personnel (including Partner Rotation) with an Audit Client**

#### ***Prohibited***

An individual shall not be a key audit partner for more than seven years. After such time, the individual shall not be a member of the engagement team or a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events or otherwise directly influence the outcome of the engagement. [290.151]

#### ***Permitted if certain conditions exist or specified safeguards are applied***

Key audit partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm’s control, be permitted an additional year on the audit team as long as the threat to independence can be eliminated or reduced to an acceptable level by applying safeguards<sup>4</sup>. [290.152]

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<sup>4</sup> The Code includes transitional provisions dealing with the situation where an audit client becomes a public interest entity. [290.154]

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When a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner, rotation may not be an available safeguard. If an independent regulator in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a key audit partner for more than seven years, in accordance with such regulation, provided that the independent regulator has specified alternative safeguards which are applied, such as a regular independent external review. [290.155]

### ***Requires an analysis of threats and application of safeguards, when necessary***

Senior personnel, other than key audit partners, have been involved in an audit engagement over a long period of time. [290.150/3]

### **Provision of Non-assurance Services to Audit Clients**

#### ***Prohibited***

A firm shall not assume a management responsibility for an audit client. [290.165]

Activities that are routine and administrative, or involve matters that are insignificant, generally are deemed not to be a management responsibility. [290.164]

#### ***Permitted if certain conditions exist or specified safeguards are applied***

The firm shall be satisfied that a member of management is responsible for making the significant judgments and decisions that are the proper responsibility of management, evaluating the results of the non-assurance service and accepting responsibility for the actions to be taken arising from the results of the service. [290.166]

A non-assurance service that had been provided to an audit client when it was not a public interest entity does not compromise the firm's independence when the client becomes a public interest entity if:

- The service complied with the provisions of the Code applicable to clients that not public interest entities;
- Services that are no longer permitted are terminated before or as soon as practicable after the client becomes a public interest entity; and
- The firm applies safeguards when necessary to eliminate or reduce to an acceptable level any threats to independence created by the service. [290.161]

### ***Requires an analysis of threats and application of safeguards, when necessary***

Before the firm accepts an engagement to provide a non-assurance service, a determination shall be made as to whether providing such a service would create a threat to independence. Consideration shall be given to any threat that the audit team has reason to believe is created by providing other related non-assurance services. If a threat is created that cannot be reduced to an acceptable level by the application of safeguards, the non-assurance service shall not be provided. [290.158]

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Non-assurance services that would otherwise be restricted under the Code may be provided to certain related entities if it is reasonable to conclude that (a) the services do not create a self-review threat because the results of the services will not be subject to audit procedures and (b) any threats that are created by the provision of such services are eliminated or reduced to an acceptable level by the application of safeguards. [290.160]

### ***Inadvertent Violation***

The inadvertent provision of a prohibited non-assurance service to a related entity, division or in respect of a discrete financial statement item of the client will be deemed not to compromise independence if any threats 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. [290.159]

### **Preparing Accounting Records and Financial Statements**

#### ***Prohibited***

Providing accounting and bookkeeping services, including payroll services, preparing the client's financial statements, and preparing financial information that forms the basis of the financial statements. [290.172]

#### ***Permitted if certain conditions exist or specified safeguards are applied***

Accounting and bookkeeping services, including payroll services and the preparation of financial statements or other financial information, of a routine or mechanical nature for divisions or related entities of an audit client if the personnel providing the services are not members of the audit team and:

- The divisions or related entities for which the service is provided are collectively immaterial to the financial statements on which the firm will express an opinion; or
- The services relate to matters that are collectively immaterial to the financial statements of the division or related entity. [290.173]

Accounting and bookkeeping services, which would otherwise not be permitted, may be provided to audit clients in emergency or other unusual situations when it is impractical for the audit client to make other arrangements, provided that the following conditions are met:

- Those who provide the services are not members of the audit team;
- The services are provided for only a short period of time and are not expected to recur; and
- The situation is discussed with those charged with governance. [290.174]

#### ***Other provisions***

The following activities are considered to be a normal part of the audit process and do not, generally, create threats to independence - dialogue with management on (a) the application of accounting standards or policies and financial statement disclosure requirements, (b) the

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

appropriateness of financial and accounting control and the methods used in determining the stated amounts of assets and liabilities, or (c) proposing adjusting journal entries. [290.169]

Similarly, the following services do not, generally, create threats to independence - technical assistance on matters such as resolving account reconciliation problems or analyzing and accumulating information for regulatory reporting, and providing technical advice on accounting issues such as the conversion of existing financial statements from one financial reporting framework to another. [290.170]

### **Valuation Services**

#### ***Prohibited***

Valuation services where the valuation would have a material effect, separately or in the aggregate, on the financial statements. [290.180]

#### ***Requires an analysis of threats and application of safeguards, when necessary***

Valuation services that would not have a material effect on the financial statements. [290.176]

### **Tax Services**

#### **Tax return preparation**

#### ***Requires an analysis of threats and application of safeguards, when necessary***

Tax return preparation services do not generally create a threat to independence if management takes responsibility for the returns including any significant judgments made. [290.183]

#### **Tax Calculations for the Purpose of Preparing Accounting Entries**

#### ***Prohibited***

Preparing tax calculations of current and deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are material to the client's financial statements. [290.185]

#### ***Permitted if certain conditions exist or specified safeguards are applied***

Preparing the tax calculations for purposes of preparing accounting entries that are material to the financial statements if the audit client is in an emergency or other unusual situation, it is impractical for the client to make other arrangements, and the following conditions are met:

- a) Those who provide the services are not members of the audit team;
- b) The services are provided for only a short period of time and are not expected to recur; and
- c) The situation is discussed with those charged with governance. [290.185 and 186]

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### ***Requires an analysis of threats and application of safeguards, when necessary***

Preparing the tax calculations for purposes of preparing accounting entries that not material to the financial statements. [290.7]

### **Tax Planning and Other Tax Advisory Services**

#### ***Prohibited***

Providing tax advice where the effectiveness of the advice depends on a particular accounting treatment or presentation in the financial statements if:

- The audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework; and
- The outcome or consequences of the tax advice will have a material effect on the financial statements on which the firm will express an opinion. [290.190]

#### ***Permitted if certain conditions exist or specified safeguards are applied***

Where a valuation is performed for tax purposes only and the result of the valuation will affect the financial statements only through accounting entries related to tax, this would not generally create threats to independence if such effect is immaterial or if the valuation is subject to external review by a tax authority or similar regulatory authority. [290.191]

### ***Requires an analysis of threats and application of safeguards, when necessary***

A valuation for tax purposes only, as described above, that is not subject to an external review by a tax or similar regulatory authority or for which the effect is material to the financial statements. [290.191]

Tax planning or other tax advisory services that affect matters to be reflected in the financial statements. [290.188/189]

### **Assistance in the Resolution of Tax Disputes**

#### ***Prohibited***

Acting as an advocate for an audit client before a public tribunal or court in the resolution of a tax matter if the amounts involved are material to the financial statements. [290.193]

### ***Requires an analysis of threats and application of safeguards, when necessary***

Representing the client in the resolution of a tax dispute once the tax authorities have notified the client that they have rejected the client's arguments on a particular issue and either the tax authority or the client is referring the matter for determination in a formal proceeding, for example, before a tribunal or court. [290.192]

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

### Internal Audit Services

#### *Prohibited*

Provide internal audit services that relate to:

- (a) A significant part of the internal controls over financial reporting;
- (b) Financial accounting systems that generate information that is, separately or in the aggregate, significant to the client's accounting records or financial statements on which the firm will express an opinion; or
- (c) Amounts or disclosures that are, separately or in the aggregate, material to the financial statements on which the firm will express an opinion. [290.200]

#### *Permitted if certain conditions exist or specified safeguards are applied*

Internal audit services that are not prohibited, if the firm is satisfied that all of the following exist:

- (a) The client designates an appropriate and competent resource, preferably within senior management, to be responsible at all times 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 the internal audit services;
- (c) The client's management evaluates the adequacy of the internal audit services and the findings resulting from their performance;
- (d) The client's management evaluates and determines which recommendations resulting from internal audit services 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 services. [290.198]

#### *Requires an analysis of threats and application of safeguards, when necessary*

Internal audit services that are not prohibited, where the results of those services will be used in conducting the external audit. [290.199]

### IT Systems Services

#### *Prohibited*

Designing or implementing IT systems that (a) form a significant part of the internal control over financial reporting or (b) generate information that is significant to the client's accounting records or financial statements. [290.206]

#### *Requires an analysis of threats and application of safeguards, when necessary*

Designing or implementing IT systems that form part (but not a significant part) of the internal control over financial reporting or generate information that affects (but is not significant to) the accounting records or financial statements. [290.7]

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

### *Other Provisions*

The following IT systems services are deemed not to create a threat to independence as long as the firm's personnel do not assume a management responsibility:

- (a) Design or implementation of IT systems that are unrelated to internal control over financial reporting;
- (b) Design or implementation of IT systems that do not generate information forming a significant part of the accounting records or financial statements;
- (c) Implementation of "off-the-shelf" accounting or financial information reporting software that was not developed by the firm if the customization required to meet the client's needs is not significant; and
- (d) Evaluating and making recommendations with respect to a system designed, implemented or operated by another service provider or the client. [290.202]

### **Litigation Support Services**

#### *Prohibited*

Estimating damages or other amounts that would have a material effect on the financial statements. [290.208 and 290.180]

#### *Requires an analysis of threats and application of safeguards, when necessary*

Litigation support services that are not prohibited e.g., acting as an expert witness, estimating damages or other amounts that would not have a material effect on the financial statements, and assisting with document management and retrieval. [290.207 and 208]

### **Legal Services**

#### *Prohibited*

Acting in an advocacy role for the client in resolving a dispute or litigation when the amounts involved are material to the financial statements. [290.211]

A partner or employee of the firm accepting an appointment as General Counsel for an audit client. [290.213]

#### *Requires an analysis of threats and application of safeguards, when necessary*

- Legal services that support an audit client in executing a transaction (e.g., contract support, legal advice, legal due diligence and restructuring). [290.210]
- Acting in an advocacy role for an audit client in resolving a dispute or litigation when the amounts involved are not material to the financial statements. [290.212]

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

### **Recruiting Services**

#### ***Prohibited***

Acting as a negotiator on the client's behalf, making the hiring decision for the client, or assuming any other management responsibilities. [290.214]

With respect to a director or officer of the entity or senior management in a position to exert significant influence over the preparation of the client's accounting records or the financial statements:

- Searching for or seeking out candidates for such positions; and
- Undertaking reference checks of prospective candidates for such positions. [290.215]

#### ***Requires an analysis of threats and application of safeguards, when necessary***

Any other recruiting service that is not prohibited, such as reviewing the professional qualifications of a number of applicants and providing advice on their suitability for the post, and interviewing candidates and advising on a candidate's competence for financial accounting, administrative, or control positions. [290.214]

### **Corporate Finance Services**

#### ***Prohibited***

Providing corporate finance advice where the effectiveness of the advice depends on a particular accounting treatment or presentation in the financial statements if:

- (a) The audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework; and
- (b) The outcome or consequences of the corporate finance advice will have a material effect on the financial statements on which the firm will express an opinion. [290.218]

Providing corporate finance services involving promoting, dealing in, or underwriting the client's shares. [290.219]

#### ***Requires an analysis of threats and application of safeguards, when necessary***

Providing corporate finance services that are not prohibited, such as

- Assisting in developing corporate strategies;
- Identifying possible targets for acquisition;
- Advising on disposal transactions;
- Assisting with finance raising; and
- Providing advice on the structuring of a transaction or financing arrangement [290.216 and 217]

## PART 2 – SPECIFIC PROVISIONS BY TOPIC

### Custody of client assets

#### *Permitted if certain conditions exist or specified safeguards are applied*

The professional accountant shall only assume custody of client monies or other assets if the accountant:

- Is permitted to do so by law and, if so, complies with any additional legal duties imposed on a professional accountant in public practice holding such assets; [270.1]
- Keeps such assets separately from personal or firm assets;
- Uses such assets only for the purpose for which they are intended; and
- Is at all times ready to account for those assets and any income, dividends, or gains generated, to any persons entitled to such accounting. [270.2]

### Fees

#### *Prohibited*

Charging a contingent fee, directly or indirectly, in respect of

- An audit engagement. [290.225]
- A non-assurance service provided to the client if:
  - (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 that participates in a significant part of the audit and the fee is material or expected to be material to that firm; or
  - (c) The outcome of the non-assurance service, and therefore the amount of the fee, is dependent on a future or contemporary judgment related to the audit of a material amount in the financial statements. [290.226]

#### *Permitted if certain conditions exist or specified safeguards are applied, when necessary*

For two consecutive years, the total fees from the client and its related entities [where relevant] represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, provided that 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
- Applies one of two specified safeguards - a pre- or post-issuance review that is equivalent to an engagement quality control review performed by an accountant who is not a member of the firm or by a professional regulatory body.

When the total fees significantly exceed 15%, the firm shall 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.

Thereafter, when the fees continue to exceed 15% each year, the disclosure to and discussion with those charged with governance shall occur and one of the two specified safeguards shall

## **PART 2 – SPECIFIC PROVISIONS BY TOPIC**

be applied. If the fees significantly exceed 15%, the firm shall 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. [290.222]

### ***Requires an analysis of threats and application of safeguards, when necessary***

- (a) Total fees from the client are less than 15% for two consecutive years but represent a large proportion of the total fees of the firm expressing the audit opinion. [290.220]
- (b) Fees generated from the client represent a large proportion of the revenue from an individual partner's clients or a large proportion of the revenue of an individual office of the firm. [290.221]
- (c) A firm has overdue fees from an audit client. The firm shall determine whether 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 or continue the audit engagement. [290.223]
- (d) Contingent fee arrangements charged by a firm for a non-assurance service to an audit client that are not otherwise prohibited. [290.227]

### **Compensation and Evaluation Policies**

#### ***Prohibited***

Evaluating or compensating a key audit partner based on that partner's success in selling non-assurance services to the partner's audit client. [290.229]

#### ***Requires an analysis of threats and application of safeguards, when necessary***

When a member of the audit team, other than a key audit partner, is evaluated on or compensated for selling non-assurance services to that audit client. [290.228]

### **Gifts and Hospitality**

#### ***Prohibited***

A firm or a member of the audit team shall not accept gifts or hospitality from an audit client, unless the value is trivial and inconsequential. [290.230]

### **Actual or Threatened Litigation**

#### ***Requires an analysis of threats and application of safeguards, when necessary***

When litigation takes place, or appears likely, between the firm or a member of the audit team and the audit client. [290.231]

## **PART 3 – PROVISIONS RELATING TO CHANGES IN CIRCUMSTANCES**

### **Client Mergers and Acquisitions**

When, as a result of a merger or acquisition, an entity becomes a related entity of an audit client, the firm shall

- Identify and evaluate previous and current interests and relationships with the related entity that, taking into account available safeguards, could affect its independence. [290.33]
- Take steps necessary to terminate, by the effective date of the merger or acquisition, any current interests or relationships that are not permitted under this Code.
- Evaluate the threat that is created by a current interest or relationship that cannot reasonably be terminated by the effective date.
- Discuss with those charged with governance the reasons why the interest or relationship cannot reasonably be terminated and the evaluation of the significance of the threat. [290.34] If those charged with governance request the firm to continue as auditor, the firm shall do so only if:
  - (a) the interest or relationship will be terminated as soon as reasonably possible and in all cases within six months of the effective date of the merger or acquisition;
  - (b) any individual who has such an interest or relationship, including one that has arisen through performing a non-assurance service that would not be permitted under this section, will not be a member of the engagement team for the audit or the individual responsible for the engagement quality control review; and
  - (c) appropriate transitional measures will be applied, as necessary, and discussed with those charged with governance. [290.35]

The firm may have completed a significant amount of work on the audit prior to the effective date of the merger or acquisition and may be able to complete the remaining audit procedures within a short period of time. In such circumstances, if those charged with governance request the firm to complete the audit while continuing with an interest or relationship identified, the firm shall do so only if it meets certain conditions specified in the Code. [290.36]

The firm shall determine whether, even if all the requirements could be met, the interests and relationships create threats that would remain so significant that objectivity would be compromised and, if so, the firm shall cease to be the auditor. [290.37]

The professional accountant shall document any relevant interests or relationships that will not be terminated by the effective date of the merger or acquisition and the reasons why they will not be terminated, the transitional measures applied, the results of the discussion with those charged with governance, and the rationale as to why the previous and current interests and relationships do not create threats that would remain so significant that objectivity would be compromised. [290.38]

### **Financial interests**

A prohibited financial interest received for example, by way of an inheritance, gift or as a result of a merger shall be disposed of immediately (or if received by an individual who is not a member of the audit team, as soon as possible). [290.116]

## PART 4 – RELEVANT TERMS

Acceptable level	A level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.
Audit client	An entity in respect of which a firm conducts an audit engagement. When the client is a listed entity, audit client will always include its related entities. When the audit client is not a listed entity, audit client includes those related entities over which the client has direct or indirect control.
Audit engagement	A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements are prepared, in all material respects (or give a true and fair view or are presented fairly, in all material respects), in accordance with an applicable financial reporting framework, such as an engagement conducted in accordance with International Standards on Auditing. This includes a Statutory Audit, which is an audit required by legislation or other regulation.
Audit team	<ul style="list-style-type: none"><li>(a) All members of the engagement team for the audit engagement;</li><li>(b) All others within a firm who can directly influence the outcome of the audit engagement, including:<ul style="list-style-type: none"><li>(i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the audit engagement including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent);</li><li>(ii) Those who provide consultation regarding technical or industry-specific issues, transactions or events for the engagement; and</li><li>(iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and</li></ul></li><li>(c) All those within a network firm who can directly influence the outcome of the audit engagement.</li></ul>
Close family	A parent, child or sibling who is not an immediate family member.
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 by a court or other public authority is not a contingent fee.

## PART 4 – RELEVANT TERMS

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, or the ability to influence investment decisions.</li></ul>
Director or officer	<p>Those charged with the governance of an entity, or acting in an equivalent capacity, regardless of their title, which may vary from jurisdiction to jurisdiction.</p>
Engagement quality control review	<p>A process designed to provide an objective evaluation, on or before the report is issued, of the significant judgments the engagement team made and the conclusions it reached in formulating the report.</p>
Engagement team	<p>All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or a network firm.</p>
Engagement period	<p>Independence from the audit client is required both during the engagement period and the period covered by the financial statements. The engagement period starts when the audit team begins to perform audit services. The engagement period ends when the audit report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has terminated or the issuance of the final audit report.</p>
External expert	<p>An individual (who is not a partner or a member of the professional staff, including temporary staff, of the firm or a network firm) or organization possessing skills, knowledge and experience in a field other than accounting or auditing, whose work in that field is used to assist the professional accountant in obtaining sufficient appropriate evidence.</p>
Financial interest	<p>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.</p>
Financial statements	<p>A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term can relate to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.</p>

## PART 4 – RELEVANT TERMS

Financial statements on which the firm will express an opinion	In the case of a single entity, the financial statements of that entity. In the case of consolidated financial statements, also referred to as group financial statements, the consolidated financial statements.
Firm	<ul style="list-style-type: none"><li>(a) A sole practitioner, partnership or corporation of professional accountants;</li><li>(b) An entity that controls such parties, through ownership, management or other means; and</li><li>(c) An entity controlled by such parties, through ownership, management or other means.</li></ul>
Immediate family	A spouse (or equivalent) or dependent.
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 or ability to influence investment decisions.
Key audit partner	The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, “other audit partners” may include, for example, audit partners responsible for significant subsidiaries or divisions.
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.
Materiality (290.101)	For the purpose of determining whether an interest or relationship is material to an individual, the combined net worth of the individual and the individual’s immediate family members may be taken into account.
Network	A larger structure: <ul style="list-style-type: none"><li>(a) That is aimed at co-operation; and</li><li>(b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.</li></ul>

## PART 4 – RELEVANT TERMS

Network firm	<p>A firm or entity that belongs to a network.</p> <p>Whether a network exists shall be determined in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment shall be applied consistently throughout the network. [290.15]</p>
Office	<p>A distinct sub-group, whether organized on geographical or practice lines.</p>
Public interest entity	<p>(i) A listed entity; and</p> <p>(ii) An entity (a) defined by regulation or legislation as a public interest entity or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.</p> <p>Member bodies and firms are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number and wide range of stakeholders.</p>
Related entity	<p>An entity that has any of the following relationships with the client:</p> <p>(a) An entity that has direct or indirect control over the client if the client is material to such entity;</p> <p>(b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity;</p> <p>(c) An entity over which the client has direct or indirect control;</p> <p>(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</p> <p>(e) An entity which is under common control with the client (a “sister entity”) if the sister entity and the client are both material to the entity that controls both the client and sister entity.</p>
Those charged with governance	<p>The persons with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.</p>

## PART 4 – RELEVANT TERMS

### OTHER RELEVANT DESCRIPTIONS IN THE CODE

290.1 Independence comprises:

#### *Independence of Mind*

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

#### *Independence in Appearance*

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit team's, integrity, objectivity or professional skepticism has been compromised.

[290.175] *Valuation Services*

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

[290.195] *Internal Audit Services*

The scope and objectives of internal audit activities 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:

- (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.

## **PART 4 – RELEVANT TERMS**

[290.201] *IT Systems Services*

Services related to information technology (“IT”) systems include the design or implementation of hardware or software systems. The systems may aggregate source data, form part of the internal control over financial reporting or generate information that affects the accounting records or financial statements, or the systems may be unrelated to the audit client’s accounting records, the internal control over financial reporting or financial statements. Providing systems services may create a self-review threat depending on the nature of the services and the IT systems.

## PART 4 – RELEVANT TERMS

[290.207] *Litigation Support Services*

Litigation support services may include activities such 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. These services may create a self-review or advocacy threat.

[290.209] *Legal Services*

For the purpose of this section, legal services are defined as any services for which the person providing the services must either be admitted to practice law before the courts of the jurisdiction in which such services are to be provided or have the required legal training to practice law. Such legal services may include, depending on the jurisdiction, a wide and diversified range of areas including both corporate and commercial services to clients, such as contract support, litigation, mergers and acquisition legal advice and support and assistance to clients' internal legal departments. Providing legal services to an entity that is an audit client may create both self-review and advocacy threats.

[290.216] Corporate finance services [include] (a) assisting an audit client in developing corporate strategies, (b) identifying possible targets for the audit client to acquire, (c) advising on disposal transactions, (d) assisting finance raising transactions, and (e) providing structuring advice.

Management Responsibilities Management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources. [290.162]

Whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would generally be considered a management responsibility include:

- Setting policies and strategic direction;
- Directing and taking responsibility for the actions of the entity's employees;
- Authorising transactions;
- Deciding which recommendations of the firm or other third parties to implement;
- Taking responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; and
- Taking responsibility for designing, implementing and maintaining internal control. [290.163]

## PART 4 – RELEVANT TERMS

Threats to compliance with the fundamental principles

### **THREATS FALL INTO ONE OR MORE OF THE FOLLOWING CATEGORIES:**

- (a) Self-interest threat - the threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior;
- (b) Self-review threat - the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made or service performed by the professional accountant, or by another individual within the professional accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of providing a current service;
- (c) Advocacy threat - the threat that a professional accountant will promote a client's or employer's position to the point that the professional accountant's objectivity is compromised;
- (d) Familiarity threat - the threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat - the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant.

Safeguards

Safeguards are actions or other measures that may eliminate threats or reduce them to an acceptable level. They fall into two broad categories:

- (a) Safeguards created by the profession, legislation or regulation; and
- (b) Safeguards in the work environment.

The Code provides the following examples.

### **SAFEGUARDS CREATED BY THE PROFESSION, LEGISLATION OR REGULATION INCLUDE:**

- Educational, training and experience requirements for entry into the profession.
- Continuing professional development requirements.
- Corporate governance regulations.
- Professional standards.
- Professional or regulatory monitoring and disciplinary procedures.
- External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.

## PART 4 – RELEVANT TERMS

### EXAMPLES OF FIRM-WIDE SAFEGUARDS IN THE WORK ENVIRONMENT INCLUDE (200.12):

- Leadership of the firm that stresses the importance of compliance with the fundamental principles.
- Leadership of the firm that establishes the expectation that members of an assurance team will act in the public interest.
- Policies and procedures to implement and monitor quality control of engagements.
- Documented policies regarding the need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats to an acceptable level or, when appropriate safeguards are not available or cannot be applied, terminate or decline the relevant engagement.
- Documented internal policies and procedures requiring compliance with the fundamental principles.
- Policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients.
- Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client.
- Using different partners and engagement 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 an engagement team from inappropriately influencing the outcome of the engagement.
- Timely communication of a firm's policies and procedures, including any changes to them, to all partners and professional staff, and appropriate training and education on such policies and procedures.
- Designating a member of senior management to be responsible for overseeing the adequate functioning of the firm's quality control system.
- Advising partners and professional staff of assurance clients and related entities from which **independence** is required.
- A disciplinary mechanism to promote compliance with policies and procedures.
- Published policies and procedures to encourage and empower staff to communicate to senior levels within the firm any issue relating to compliance with the fundamental principles that concerns them.

## **PART 4 – RELEVANT TERMS**

### **EXAMPLES OF ENGAGEMENT-SPECIFIC SAFEGUARDS IN THE WORK ENVIRONMENT INCLUDE (200.13):**

- Having a professional accountant who was not involved with the non-assurance service review the non-assurance work performed or otherwise advise as necessary.
- Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary.
- Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- Discussing ethical issues with those charged with governance of the client.
- Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
- Involving another firm to perform or re-perform part of the engagement.
- Rotating senior assurance team personnel.

200.14

Depending on the nature of the engagement, a professional accountant in public practice may also be able to rely on safeguards that the client has implemented. However it is not possible to rely solely on such safeguards to reduce threats to an acceptable level.

### **EXAMPLES OF SAFEGUARDS WITHIN THE CLIENT'S SYSTEMS AND PROCEDURES INCLUDE (200.15):**

- The client requires persons other than management to ratify or approve the appointment of a firm to perform an engagement.
- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that ensure objective choices in commissioning non-assurance engagements.
- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.