

*Section 290 of the Code of Ethics*

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**Independence – Audit and  
Review Engagements**

*Section 291 of the Code of Ethics*

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**Independence – Other Assurance  
Engagements**



## REQUEST FOR COMMENTS

The International Ethics Standards Board for Accountants, an independent standard-setting body within the International Federation of Accountants (IFAC), approved this exposure draft, *Code of Ethics for Professional Accountants*, for publication in December, 2006. These proposed revisions to the Code may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by email, so that they will be received by **April 30 2007**. All comments will be considered a matter of public record. Comments should be addressed to:

Senior Technical Manager  
International Ethics Standards Board for Accountants  
International Federation of Accountants  
545 Fifth Avenue, 14th Floor  
New York, New York 10017 USA

Email responses should be sent to: [Edcomments@ifac.org](mailto:Edcomments@ifac.org)

Copies of this exposure draft may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

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## **EXPLANATORY MEMORANDUM**

### **Introduction**

This memorandum provides background to, and an explanation of, the proposed changes to the *Code of Ethics for Professional Accountants* (the Code), approved for exposure by the International Ethics Standards Board for Accountants (IESBA or the Board) in December 2006.

The IESBA welcomes comments on the proposed revised Section 290 and the proposed new Section 291. In addition to general comments, the IESBA welcomes comments on specific questions which are set out at the end of this document. Comments should be received by April 30, 2007.

### **Background**

The existing independence provisions in the Code were issued in November 2001 and were effective for assurance reports dated on or after December 31, 2004 with earlier application encouraged. Since then, several corporate failures have led to a loss of credibility in aspects of the financial reporting process and many jurisdictions have taken steps to restore credibility. Some of these steps have related to independence requirements for accountants performing assurance engagements. Accordingly, IESBA concluded it was appropriate to commence a project to determine whether to revise any of the independence requirements contained in Section 290 of the Code.

In considering which parts of Section 290 might need to be revised, the IESBA sent a questionnaire to member bodies of IFAC to obtain information on implementation experience and to identify any areas where a member body had supplemented the Code with additional requirements. The IESBA considered the information received and, in October 2005, held a public forum to solicit input on which parts of Section 290 should be revised. The approximately 150 Forum participants included regulators, standards setters, leaders of accountancy organizations and members of the profession. The participants supported the principles-based approach in the Code and suggested ways in which it might be clarified or augmented to provide auditors with clearer guidance in addressing independence issues. The IESBA considered the input received at the Forum in developing this exposure draft. The IESBA has also benchmarked the existing Section 290 to the independence requirements in a number of jurisdictions to identify matters to be reconsidered.

### **Scope of Revisions**

The independence of professional accountants performing assurance engagements is fundamental to the credibility of financial reporting. Over the two-year development period of this exposure draft, the IESBA considered the above input to determine what changes are appropriate to enhance the independence, and therefore the objectivity, of professional accountants performing assurance engagements. The IESBA has reviewed the Code and determined that:

- (a) Certain matters, as explained in this memorandum, require significant modification;
- (b) Certain matters, as explained in this memorandum, do not require significant modification; and
- (c) The following matters which, while important, are not of a priority nature:
  - Whether it is appropriate to revise the existing guidance related to the provision of internal audit services to audit clients

- Whether it is appropriate to include additional guidance related to economic dependence in the paragraphs dealing with fees in Section 290 (and proposed Section 291); and
- Whether it is appropriate to revise the existing guidance relating to contingent fees.

Comments are requested in respect of the position taken on matters described in (a) and (b) above. Matters included in (c) above will be addressed in subsequent revisions to the Code, and therefore, the IESBA is not seeking any comments on these matters at this time.

During 2007, the IESBA will develop and expose for comment a draft strategic and operational plan for the period 2008-2009. The IESBA will solicit input on future potential projects and priorities, including whether any further enhancements to proposed revised Section 290 and new Section 291 are needed.

## **Significant Proposals**

### **Language and Drafting**

In developing the exposure draft, the IESBA has taken steps to make the language, and in particular the specific restrictions, more direct. In addition, the IESBA has adopted an approach to minimize repetition, for example by stating that the term “audit engagement” includes “review engagement.”

The IESBA has not yet addressed the implications for the Code of the new drafting conventions adopted under the Clarity Project by the International Auditing and Assurance Standards Board (IAASB). The IESBA’s proposed strategic and operational plan (referred to above) contemplates consideration by the Board of the implications of this project for the Code. The IESBA is therefore not seeking comments on the implications of the Clarity project at this time.

### **Split of Section 290**

The existing Code contains one section that addresses independence requirements for all assurance engagements. However, because most assurance engagements are either audit or review engagements, the IESBA has revised Section 290 to address only audit and review engagements.

Audit engagements are assurance engagements in which a professional accountant expresses an opinion on whether historical financial information is prepared in all material respects with an identified financial reporting framework. Such engagements include audit engagements to report on:

- A complete set of general purpose financial statements;
- A complete set of financial statements prepared in accordance with a framework designed for a special purpose;
- A single financial statement; and
- One or more specific elements, accounts or items of a financial statement.

The IESBA is of the view that all such engagements should be addressed in proposed revised Section 290. In all such engagements the professional accountant obtains reasonable assurance that the information is prepared in all material respects with the identified financial reporting framework. The IESBA is of the view that a reasonable and informed third party would expect that the same

independence requirements had been met in an audit of a complete set of financial statements as in an audit of a single financial statement or one or more specific accounts or elements of a financial statement.

A review engagement is a limited assurance engagement performed in accordance with International Standards on Review Engagements issued by the IAASB, or equivalent standards. The IESBA has concluded that such engagements should be addressed in proposed revised Section 290 together with audit engagements, rather than in proposed new Section 291 with “other assurance engagements”. In both audit and review engagements the accountant is expressing a conclusion on historical financial information and in many review engagements the accountant is expressing a conclusion on a complete set of financial statements. The subject matter and subject matter information of the engagement is the same as in an audit engagement; the difference is the level of assurance obtained. The IESBA, therefore, is of the view that it is appropriate to address independence requirements for audit and review engagements in one section and to address independence requirements for other assurance engagements in a separate section.

The exposure draft therefore contains two sections dealing with independence. Proposed revised Section 290 sets out the independence requirements for audit and review engagements and proposed new Section 291 sets out the independence requirements for all other assurance engagements. The IESBA is of the view that this split provides more direct and understandable guidance for those who perform only audit and review engagements.

The proposed new Section 291 addresses the independence requirements for assurance engagements that are not audit or review engagements. The section notes that if the assurance client is also an audit or review client, the requirements in proposed revised Section 290, which relate to the audit engagement, will apply to the firm, network firms and to members of the audit or review team.

### **Restricted Use**

Existing Section 290.19 states:

“In the case of an assurance report in respect of a non-financial statement audit 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 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.”

In revising these provisions, the IESBA is of the view that the restricted use provisions should be used only when the users of the report are 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. The IESBA is of the view that the provisions may be applied to an audit engagement so long as the engagement is not:

- An audit of a complete set of general purpose financial statements;
- An audit of historical financial information required by law or regulation; or
- An audit of a complete set of financial statements prepared in accordance with a financial reporting framework designed for a general purpose, but not designed to achieve fair presentation (for example, financial statements of an insurance company that are prepared for the purpose of meeting regulatory filing requirements and that may be available for general use).

The IESBA is of the view that when a firm is engaged to issue an assurance report the use of which is restricted to intended users of the report, certain modifications to the independence requirements may be made with the explicit agreement of the intended users. The firm should communicate with the intended users, directly or through their representative, regarding the independence requirements that are to be applied. Proposed revised Section 290 and proposed new Section 291 indicate the minimum provisions which should be applied in all circumstances. The Sections also indicate that where the intended users are a class of users (for example, lenders in a syndicated loan arrangement) who are not specifically identifiable by name at the time the engagement terms are established, such users should subsequently be made aware of the independence requirements that have been complied with, as agreed with their representative (for example by making the firm's engagement letter available to all users). The sections also clarify the application of the relevant provisions of Sections 290 and 291 to these reports.

## **Definitions**

### *Engagement Team*

The existing definition of engagement team is:

“All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.”

The IESBA understands that the existing definition may have unintended consequences because “any experts contracted by the firm” is broad. In an audit there are potentially many different “experts” who could be contracted by the firm, ranging from an individual who works closely with the team throughout the audit to an individual, usually on behalf of the organization they represent, who has no contact with the engagement team but does provide information about a particular matter (for example, an external lawyer who provides a legal opinion about a particular matter). The IESBA is of the view that it would be inappropriate to treat all such experts as members of the engagement team.

The IESBA is of the view that the definition of engagement team should be broader than partners of the firm and staff employed by the firm who serve on the team. Firms engage individuals (who may themselves be an expert in a particular field, such as a valuations specialist) to perform audit support activities that might otherwise be performed by partners or staff of the firm. Also, firms often

contract with outside audit professionals at times of peak activity to supplement staff levels. The IESBA is of the view that such individuals should be considered to be part of the engagement team because they are performing functions that would otherwise be performed by a partner or staff of the firm. The individual's legal relationship with the firm should not be the factor that determines whether or not he or she has to comply with independence requirements.

Accordingly, the IESBA proposes amending the definition to read:

“All partners and staff performing the engagement and any individuals contracted by the firm who provide services on the engagement that might otherwise be provided by a partner or staff of the firm.”

#### *Financial Statements*

The IESBA proposes including a revised definition of financial statements that is consistent with the definition used by the IAASB.

#### *Historical Financial Information*

The IESBA proposes including a definition of historical financial information that is consistent with the definition used by the IAASB.

#### *Key Audit Partner*

The IESBA proposes including a new term “key audit partner” that would be defined as follows:

“The engagement partner, the individual responsible for the engagement quality control review, and other audit partners on the engagement team, such as lead partners on significant subsidiaries or divisions, who are responsible for key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion.”

The term is used in the provisions on employment relationships, partner rotation and compensation. The definition of key audit partner focuses on the whether a partner is responsible for key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. For example, in the audit of consolidated financial statements, if the audit partner of a significant subsidiary is responsible for key decisions or judgments on significant matters with respect to the consolidated financial statements that individual would be considered to be a key audit partner.

### **Section 290 Independence – Audit and Review Engagements**

#### *Network Firms*

Paragraphs 290.10 to 290.21 are provided to enable recipients to read Section 290 in context. The guidance for network firms and the requirements that they be independent of audit clients of other network firms was issued in June 2006, after the Board completed its due process and deliberations. Accordingly, comments are not being sought on these paragraphs.

*Entities of Significant Public Interest*

Existing Section 290.28 contains the following guidance on the application of the independence requirements to audits of entities of 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 may include listed companies, credit institutions, insurance companies, and pension funds . . . Consideration should be given to the application of the framework in relation to the financial statement audit of listed entities to other financial statement audit clients that may be of significant public interest.”

Recognizing the need for more specific guidance and in light of the public interest associated with a wide range of entities, the IESBA is proposing to strengthen this guidance. The proposal will extend the listed entity independence provisions to all entities of significant public interest. Such entities are described in proposed revised Section 290 as listed entities and certain other entities which, because of their business, size or number of employees have a large number and wide range of stakeholders.

When developing guidance on which entities should be considered an entity of significant public interest, the Board reviewed the guidance of other jurisdictions. That review indicated that there were similarities in approach, for example, including listed entities within the definition of public interest entities and including certain other entities based on a size test. There were, however, significant differences in the application of a size test. Further, in some jurisdictions entities considered to be of significant public interest for independence purposes are defined by law or regulation. In considering this information, the Board concluded that it was impracticable to develop a single definition of an entity of significant public interest that would have global application and be suitable in all jurisdictions. Accordingly, in those jurisdictions where entities considered to be of significant public interest for independence purposes are defined by law or regulation, the IESBA concluded that this definition should be used in applying the requirements of proposed revised Section 290. In the absence of such a definition, the IESBA concluded that member bodies should determine the types of entities that are of significant public interest in their particular jurisdictions.

The IESBA is of the view that because of the significant public interest associated with listed entities, such entities should always be considered to be entities of significant public interest. Therefore, audits of such entities should always be subject to the enhanced safeguards contained in Section 290. Accordingly proposed revised Section 290 states that entities of significant public interest will always include listed entities.

For other entities, the exposure draft contains some flexibility for each jurisdiction to determine, based on the facts and circumstances, which entities should be considered to be entities of significant public interest in that particular jurisdiction. While there is a presumption that regulated financial institutions will be considered to be entities of significant public interest, the Board recognizes that in some jurisdictions, it is possible that certain regulated financial institutions would not have a large number and a wide range of stakeholders and thus, the extent of public interest in those entities would not be significant. Conversely, some pension funds, government-agencies, government-controlled entities and not-for-profit entities may have a large number and wide range of stakeholders and should, therefore, be treated as entities of significant public interest. Accordingly, proposed revised Section 290 states that “depending on the facts and circumstances” entities of

significant public interest will normally include regulated financial institutions, such as banks and insurance companies, and may include pension funds, government-agencies, government-controlled entities and not-for-profit entities.

In the absence of a legislative definition, member bodies will need to determine which entities, in addition to listed entities, will be treated as entities of significant public interest. Member bodies may find it useful to consult with those who regulate entities that might be considered to be entities of significant public interest to determine which particular entities should be categorized as such for independence purposes.

The proposal indicates that in the case of an audit client that is a non-listed entity of significant public interest, in certain circumstances, depending on the nature and structure of the client's organization, it may not be necessary to apply the enhanced safeguards applicable to listed entities to all related entities of the client to maintain independence. The IESBA recognizes that in the case of certain entities of significant public interest, including many government-controlled entities which do not have a typical corporate structure, application of the enhanced safeguards to all related entities is overly broad and unnecessary to maintain independence.

#### *Financial interests*

The IESBA is of the view that the guidance in existing Section 290 should be strengthened or clarified in three areas.

- (a) IESBA is of the view that a member of the audit team, or his or her immediate family member, should not have a financial interest in an entity that has a controlling interest in the audit client, if the client is material to the entity, irrespective of whether the client is a listed entity or not. The IESBA is of the view that the self-interest threat in such a situation would be so significant that it could not be addressed by safeguards. In existing Section 290 this provision applies to audit teams on listed entity audit clients because the controlling entity would constitute a related entity of the audit client. The IESBA is of the view that it should also apply to audit clients that are not listed entities.
- (b) Existing Section 290 restricts a firm from having a material financial interest in an entity that has a controlling interest in a financial statement audit client. The proposed revised Section 290 would restrict holding a financial interest only if the audit client was material to the parent. The IESBA is of the view that this modification is appropriate because the restriction would then reflect the relative impact of the client's financial position on the parent and thus on the financial interest held by the firm.
- (c) The proposed revised Section 290 indicates that when an immediate family member of (a) a partner in the office in which the engagement partner practices in connection with the audit or (b) a partner or managerial employee who provides non-audit services to the audit client receives a financial interest in the audit client as a result of his or her employment rights, the interest should be disposed of or forfeited as soon as practicable once the individual has the right to dispose of the financial interest, or in the case of a stock option, the right to exercise the option.

#### *Loans and Guarantees*

The IESBA is not proposing significant change in this area.

*Close Business Relationships*

The IESBA is not proposing significant change in this area.

*Family and Personal Relationships*

The IESBA is not proposing significant change in this area.

*Employment with an Audit Client*

Proposed revised Section 290 provides additional guidance on employment with audit clients that are entities of significant public interest. Under the proposed revisions, if a key audit partner or the individual who is the firm's Senior or Managing Partner joined an audit client that is an entity of significant public interest before a specific period of time (a "cooling-off period") had elapsed, independence would be compromised if the position with the client is:

- One that enables the individual to exert significant influence over the preparation of the entity's accounting records or its financial statements; or
- A director or an officer of the entity.

For key audit partners, the cooling-off period would be a period of not less than 12 months covered by audited financial statements for which the partner was not a member of the audit team for any part of the period. The IESBA is of the view that the self-interest, familiarity or intimidation threats would be so significant that no safeguards could reduce these threats to an acceptable level unless the entity had been through one complete annual audit cycle covering at least a 12 month period for which the former key audit partner was not involved.

The proposal is illustrated in the following scenarios:

The entity has a December 31 year end. The key audit partner was a member of the audit team for the December 31, 20x6 year-end but was not a member of the audit team for the December 31, 20x7 year end. The December 31, 20x7 audited annual financial statements are issued on March 27, 20x8. Independence would be compromised if the key audit partner joined the audit client in one of the specified positions on or before March 27, 20x8.

The entity has a December 31 year end. The key audit partner was a member of the audit team for the December 31, 20x6 year-end and was involved in the review of the first quarter interim financial information for 20x7. The December 31, 20x7 audited annual financial statements are issued on March 27, 20x8 and the December 31, 20x8 audited annual financial statements are issued on March 23, 20x9. Independence would be compromised if the key audit partner joined the audit client in one of the specified positions on or before March 23, 20x9.

Under the proposal independence would also be compromised if the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent) joins an audit client of the firm that was an entity of significant public interest in one of the specified positions noted above unless twelve months have elapsed since the individual was the Senior or Managing Partner (Chief Executive or equivalent) of the firm. The IESBA is of the view that a twelve month cooling-off period is necessary to address the potential intimidation threat.

The IESBA considered whether the cooling-off provisions should be extended, for example, to other members of the audit team or other partners in the firm. The IESBA concluded that while threats may be created if such individuals join an audit client in certain positions, as long as there is no significant connection between the individual and the firm, the threats may be addressed by applying appropriate safeguards. The IESBA, therefore, concluded it was not appropriate to require a mandatory cooling-off period for individuals other than key audit partners and the individual who is the firm's Senior or Managing Partner.

#### *Temporary Staff Assignments*

Existing Section 290 contains guidance on temporary staff assignments under the heading of the "Provision of Non-assurance Services". It states that such assistance can be provided if any threats are reduced to an acceptable level, so long as the personnel are not involved in making management decisions, approving or signing agreements (or other similar documents) or exercising discretionary authority to commit the client.

The IESBA has considered this position and is of the view that the discussion of temporary staff assignments is not appropriately classified under the broad heading of non-assurance services because the issues addressed are more closely linked to issues that can arise from employment relationships with an audit client. The proposed revised Section 290, therefore, includes guidance on temporary staff assignments in a separate section that follows the guidance on employment with an audit client. The IESBA is also of the view that the guidance should be strengthened to indicate that such assistance should be provided only for a short period of time and the guidance should be clarified to state that loaned staff should not be involved in providing non-assurance services that would otherwise be restricted under the section.

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

The IESBA is not proposing significant change in this area.

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

The IESBA is not proposing significant change in this area.

#### *Association of Senior Personnel (Including Partner Rotation)*

Existing Section 290 recognizes that using the same senior personnel on an audit engagement over a long period of time may create a familiarity threat. The existing section further provides that for the audits of listed entities, the engagement partner and the individual responsible for the engagement quality control review should be rotated after a pre-defined period, normally no more than seven years, and should not participate in the audit engagement until a further period of time, normally two years, has elapsed. The existing section also provides that when a firm has only a few people with the necessary knowledge and experience to serve as the engagement partner, or the individual responsible for the engagement quality control review, rotation may not be an appropriate safeguard. In these circumstances, the existing section provides that firms should apply other safeguards to address the threat.

The IESBA has considered this guidance and in particular, the need to strike a balance between addressing the familiarity threat by bringing a fresh look to the audit and the need to maintain continuity and audit quality. The IESBA recognizes that in larger engagements, key audit partners,

other than the engagement partner and the individual responsible for the engagement quality control review, may play a significant role in the performance of the audit and maintaining ongoing relationships with client management. The proposed revised Section 290 therefore, addresses the familiarity threat by extending the partner rotation requirements to all key audit partners on an audit of an entity of significant public interest.

The IESBA considered the length of time after which rotation should be required and the length of time before the individual may return to the audit team. The IESBA recognizes that in some jurisdictions a limited number of individuals have the knowledge and competencies to be a key audit partner on entities of significant public interest. The IESBA is, therefore, of the view that the existing requirement of seven years on the team and two years off strikes an appropriate balance between requiring the necessary fresh look and the need for continuity of key individuals.

The IESBA considered whether it was appropriate to maintain the existing position that alternative safeguards may be applied by firms with only a few people with the necessary knowledge and experience to serve as key audit partners. The IESBA is of the view that on balance, such flexibility should not be provided. The IESBA considered whether alternative safeguards, including an external review by a regulator, were available to appropriately address the familiarity threat. The IESBA concluded that such safeguards were not adequate to address the threat, noting that a review by a regulator is performed after issuance of the audit report and may be several years after issuance. The IESBA was also mindful that if there was insufficient depth within the firm to rotate the required partners audit quality might be affected. The proposed revised Section 290, therefore, requires rotation of key audit partners on all audits of entities of significant public interest.

#### *Provision of Non-assurance Services*

##### Management Functions

Existing Section 290 does not specifically provide that acting as client management or acting in a management role for the client compromises independence. There are, however, several direct or indirect references. For example, existing paragraph 290.163 includes the safeguard of policies and procedures to prohibit professional staff from making management decisions for the assurance client, or assuming responsibility for such decisions. In considering this matter, the IESBA concluded that the revised requirements should explicitly address management functions.

The IESBA considered whether the matter should be addressed by adding a management threat as a sixth category of threat. The IESBA examined this issue and concluded that a management threat was in effect a combination of the five existing categories of threat, in particular self-interest, self-review and advocacy threats. The IESBA, therefore, concluded that it was not appropriate to add a sixth category of threat.

The proposed revised Section 290 indicates that it is not possible to specify every function that is a management responsibility. However, management functions involve leading and directing an entity, including making decisions regarding the acquisition, deployment and control of significant human, financial, physical and intangible resources. The proposal indicates that if a firm performs any management functions for an audit client, no safeguards could reduce the threat to an acceptable level and accordingly, a firm should not perform management functions for an audit client. The IESBA is of the view that the performance of management functions is incompatible with the

provision of audit services because the firm becomes too closely aligned with the views and interests of management.

The proposed revised Section 290 also indicates that some activities may not be management functions if they are routine and administrative, involve matters that are insignificant or are not otherwise a management responsibility. It also provides some examples of such activities.

The proposed revised Section 290 requires the firm to be satisfied that a member of management has been designated to make all significant judgments and decisions connected with the firm's performance of non-assurance services and to accept responsibility for actions to be taken arising from the results of the services. The IESBA is of the view that this is necessary to reduce the risk of the firm stepping into the shoes of management and inadvertently making significant judgments or decisions that are properly the responsibility of management.

#### Preparing Accounting Records and Financial Statements

The IESBA is of the view that the guidance in existing Section 290 on preparing accounting records and financial statements is on the whole appropriate and is not, therefore, proposing significant change in this area. The proposed revised Section 290 does clarify that accounting and bookkeeping services may be provided in emergency situations or other unusual situations when it is impractical for the audit client to make other arrangements, such as where only the firm has the resources and the necessary knowledge of the client's systems and procedures to assist the client in the timely preparation of its accounting records and financial statements, and where a restriction on the firm's ability to provide the services would result in significant difficulties for the client. The IESBA is of the view this proposed change clarifies the existing position.

#### Valuation Services

Under existing Section 290, the guidance related to the provision of valuation services is the same for listed and non-listed audit clients. In both cases the self-review threat would be too significant if the valuation involves matters material to the financial statement and involves a significant degree of subjectivity. The IESBA has reviewed these provisions and is of the view that they need to be strengthened in two areas:

- (a) For audit clients that are entities of significant public interest, the IESBA is of the view that a firm should not provide a valuation service if it would have a material effect on the financial statements. This enhanced safeguard is necessary to address the significant public interest in such entities. Accordingly, under the proposal a material valuation for an audit client that is an entity of significant public interest would compromise independence irrespective of the subjectivity associated with the valuation.
- (b) To ensure consistent application of the Code, the IESBA is proposing additional guidance on the meaning of significant subjectivity. Proposed revised Section 290 states that certain valuations do not involve a significant degree of subjectivity. This is likely to be the case where the underlying assumptions are determined by law or regulation or are widely accepted and when the techniques and methodologies to be used are based on generally accepted standards or are prescribed by law or regulation. In such circumstances, the results of a valuation performed by two or more parties are not likely to be materially different.

## Taxation Services

Existing Section 290 states that taxation services are generally not seen to create a threat to independence. The IESBA has considered whether this position continues to be appropriate and has concluded that, given the public interest in this type of service, additional guidance in this area is necessary. The proposed revised Section 290 recognizes that performing certain tax services may create self-review and advocacy threats and contains guidance on four broad categories of taxation services:

- *Tax return preparation* – These services involve assisting clients with their tax reporting obligations. The IESBA is of the view that such services do not generally threaten independence as long as management takes responsibility for the returns including any significant judgments made.
- *Preparation of tax calculations* – The IESBA is of the view that preparing calculations of tax liabilities (or assets) for an audit client for the purposes of preparing accounting entries that will be subsequently audited by the firm may create a self-review threat. In addition, for audit clients that are entities of significant public interest, the public interest is such that the firm should not perform calculations for the primary purpose of preparing accounting entries that are material to the financial statements.
- *Tax planning and other tax advisory services* – The IESBA is of the view that a self-review threat may be created where the advice will affect matters to be reflected in the financial statements. In addition, where the effectiveness of the advice depends on a particular accounting treatment or presentation and there is reasonable doubt as to the appropriateness of the treatment or presentation, and the outcome of the advice will have a material effect on the financial statements the advice should not be provided because the self-review threat would be so significant no safeguards could address the threat.
- *Assistance in the resolution of tax disputes* – The IESBA is of the view that an advocacy threat may be created when the firm represents an audit client in the resolution of a tax dispute once the tax authorities have made it known that they have rejected the audit client's arguments on a particular issue and are referring the matter for determination in a formal proceeding, for example before a tribunal or court. In addition, where the services involve acting as an advocate for an audit client before a public tribunal or court in the resolution of a tax matter and the amounts are involved are material to the financial statements, the service should not be provided because the advocacy threat would be so significant no safeguards could address the threat. What constitutes a public tribunal or court should be determined according to how tax proceedings are heard in the particular jurisdiction.

## Internal Audit Services

The IESBA is not proposing any changes to these requirements at this time. This topic will be the subject of future deliberations of the IESBA and, accordingly, comments are not being sought on these paragraphs.

## IT Systems Services

Existing Section 290 provides that IT services involving 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 threat that is likely to be too significant unless certain specified safeguards are applied. The existing section also provides that providing design *or* implementation services may create a threat. The IESBA has reviewed these provisions and is of the view they need to be strengthened in two areas:

- (a) For audit clients that are not entities of significant public interest, the IESBA is of the view that either the design or the implementation of financial information technology systems that form a significant part of the accounting systems, or generate information that is significant to the client's financial statements, may create a threat that is likely to be too significant unless certain specified safeguards are applied.
- (b) For audit clients that are entities of significant public interest, the IESBA is of the view that, due to the level of public interest in such entities, a firm should not provide services involving either the design or the implementation of financial information technology systems that form a significant part of the accounting systems, or generate information that is significant to the client's financial statements.

## Litigation Support Services

The IESBA is of the view that the guidance in existing Section 290 is appropriate and is not, therefore, proposing significant change in this area. The proposed revised Section 290 does clarify that the guidance on valuation services is also appropriate when the firm provides litigation support services that involve estimating damages or other amounts that affect the financial statements.

## Legal Services

The IESBA is of the view that the guidance in existing Section 290 is appropriate and is not, therefore, proposing significant change in this area.

## Recruiting Senior Management

Existing Section 290 states that the recruitment for an audit client of senior management such as individuals in a position to affect the subject matter information (financial statements) may create threats to independence. It further states that in all cases the firm should not undertake management functions, including acting as negotiator or mediator on the client's behalf, and the decision as to whom to hire should be left to the client.

The IESBA has reviewed these provisions and is of the view they need to be strengthened for situations when such services are provided to an audit client that is an entity of significant public interest. The proposed revised Section 290 therefore restricts, for such audit clients, providing recruiting services with respect to a director or officer of the client or senior management in a position to exert significant influence over the preparation of the accounting records or the financial statements.

## Corporate Finance Services

Existing Section 290 states that certain corporate finance services should not be provided to an audit client because the threat would be so significant no safeguards could address the threat. The IESBA has reviewed these provisions and is of the view they should be strengthened to specifically address corporate finance services where the effectiveness of the advice depends on a particular accounting treatment. Therefore, proposed revised Section 290 states that, consistent with the position taken on tax advice, where the effectiveness of the corporate finance advice depends on a particular accounting treatment or presentation and there is reasonable doubt as to the appropriateness of the treatment or presentation, and the outcome of the advice will have a material effect on the financial statements, the advice should not be provided because the self-review threat would be so significant no safeguards could address the threat.

### *Fees and Compensation and Evaluation Policies*

Existing Section 290 provides guidance on relative size of fees, overdue fees and pricing and does not address a firm's compensation and evaluation policies. The IESBA has reviewed the fees provisions and considered compensation and evaluation issues and is proposing two changes to this section:

- (a) The IESBA is of the view that the guidance on pricing is no longer appropriate. Existing Section 290 states that when a firm obtains an engagement at a significantly lower fee level than charged by the predecessor firm, or quoted by another firm, the self-interest threat would not be reduced to an acceptable level unless the firm is able to demonstrate that appropriate time and qualified staff are assigned to the task, and all applicable assurance standards, guidelines and quality control procedures are being complied with. The IESBA is of the view that this guidance could be misleading because those matters are required in all circumstances – not only in circumstances when an engagement was obtained for a lower fee. This paragraph has, therefore, been deleted from the proposed revised Section 290.
- (b) The IESBA acknowledges that compensation and evaluation arrangements may create a self-interest threat and detract from audit quality by providing an inappropriate incentive to focus on the selling of non-assurance services to an audit client. Therefore, the proposed revised Section 290 states that compensating or evaluating members of an audit team for selling non-assurance services to an audit client may create a self-interest threat. It further provides that key-audit partners should not be evaluated or compensated in this manner because the threat created would be so significant that it could not be addressed by safeguards.

### *Gifts and Hospitality*

The IESBA is not proposing significant change in this area.

### *Actual or Threatened Litigation*

The IESBA is not proposing significant change in this area.

## **Section 291 Independence – Other Assurance Engagements**

With the exception of clarifying the guidance on the application of the section to restricted use engagements, the IESBA is not proposing significant changes to independence requirements for

assurance engagements that are not audit or review engagements (“other assurance engagements”). The IESBA is of the view that the provisions for other assurance engagement contained in existing Section 290 remain appropriate at this time. The IESBA is of the view that as the market for other assurance services matures it may be appropriate to develop additional independence requirements for such engagements.

## **Effective Date**

The IESBA proposes that the requirements in proposed revised Section 290 and new Section 291 be effective one year after approval of the final requirements, subject to the transitional provisions which are discussed below. In determining the appropriate effective date, the IESBA balanced the need for providing firms and member bodies with appropriate time to implement the new standards and effecting change as soon as possible. Assuming approval and issuance of final requirements in the first half of 2008, the effective date would be in the first half of 2009. The IESBA proposes that the provisions would become effective as of a particular date. For example, assuming the proposals are approved on March 31<sup>st</sup> 2008, the requirements would become effective on March 31<sup>st</sup> 2009. The existing independence provisions would be applicable up to March 31<sup>st</sup> 2009 and the revised provisions would become effective from March 31<sup>st</sup> 2009 onwards.

The IESBA is of the view that transitional provisions are appropriate in the following three areas (for illustrative purposes the dates provided assume approval in March 31<sup>st</sup> 2008):

- *Partner Rotation* – The proposals extend the existing partner rotation requirements to all key audit partners and to all firms, irrespective of size. The IESBA is of the view that where the proposals would require additional individuals to rotate (i.e., those not required to rotate under the existing provisions) it is appropriate to provide an additional year before this requirement is effective. Therefore, the IESBA proposes that such rotation be effective two years after the approval of the final standard. For example, key audit partners who are neither the engagement partner nor the individual responsible for the engagement quality control review would be subject to the rotation requirements after March 31<sup>st</sup> 2010. Similarly the rotation requirements would start on March 31<sup>st</sup> 2010 for firms that do not currently rotate partners but rather, under the existing Code, apply alternative safeguards to address the threat.
- *Entities of Significant Public Interest* – The proposals extend the requirements for audits of listed entities to all other entities of significant public interest. The IESBA is of the view that it is appropriate to provide an additional year before these requirements are effective. Therefore, the IESBA proposes that these requirements be effective two years after the approval of the final standard.
- *Provision of Non-Assurance Services* – The proposals expand some of the restrictions related to the provision of certain non-assurance services. The IESBA proposes that a firm should not contract for such services after the effective date of the final standard and will have six months after the effective date to complete any ongoing services that were contracted for before the effective date. For example, a firm should not contract for such services after March 31<sup>st</sup> 2009 and would have until September 30<sup>th</sup> 2009 to complete any ongoing services that were contracted for before March 31<sup>st</sup> 2009.

## **Guide for Commentators**

The IESBA welcomes comments on the proposed revised Section 290 and the proposed new Section 291. Apart from the request for specific comments set out below, the IESBA is seeking comments on all matters addressed in the exposure draft. Comments are most helpful when they refer to specific paragraphs, include the reason for the comments and, where appropriate, make specific suggestions for any proposed changes to wording to enable the IESBA to fully appreciate the respondent's position. Where a respondent agrees with proposals in the exposure draft (especially those calling for a change in current practice), it will be helpful for the IESBA to be made aware of this view.

## **Request for Specific Comments**

1. Is it appropriate to extend all of the listed entity provisions to entities of significant public interest? If not why not and which specific provisions should not be extended? Is it appropriate that, depending on the facts and circumstances, regulated financial institutions would normally be entities of significant public interest and pension funds, government-agencies, government owned entities and not-for-profit entities may be entities of significant public interest?
2. Is it appropriate to eliminate the flexibility for small firms to apply alternative safeguards to partner rotation? If such flexibility is appropriate, what alternative safeguards will eliminate the familiarity threat or reduce it to an acceptable level?
3. Is the revised guidance related to the provision of non-audit services appropriate?
4. The primary objective of the strengthening of the independence provisions of the Code is to enhance both the perceived and actual objectivity of those performing assurance engagements, thereby enhancing audit quality. Implementation of the new provisions will likely entail some additional costs to stakeholders which are particularly difficult to measure in the context of a global standard. The IESBA is, however, of the view that the benefits of the proposals are proportionate to the costs and therefore the proposals strike the appropriate balance between the differing perspectives of stakeholders. Do you agree?

## **Comments on Other Matters**

Recognizing that the proposed revised Code will apply to all professional accountants in public practice that perform assurance engagements, the IESBA is also interested in comments on matters set out below.

### *Special Considerations on Application in Audit of Small Entities*

Respondents are asked to comment on whether, in their opinion, considerations regarding the audit of small entities have been dealt with appropriately in the proposed revisions to the Code. Reasons should be provided if not in agreement, as well as suggestions for alternative or additional guidance.

### *Developing Nations*

The IESBA welcomes comments on any foreseeable difficulties in applying the proposed provisions in a developing nation environment. Reasons should be provided, as well as suggestions for alternative or additional guidance.

*Translations*

The IESBA welcomes comment from respondents on potential translation issues noted in reviewing this exposure draft.

## SECTION 290

### Independence – Audit and Review Engagements

#### Objective and Structure of this Section

290.1 This section addresses the **independence**<sup>\*</sup> requirements for audit and review engagements, which are **assurance engagements**<sup>\*</sup> in which a **professional accountant**<sup>\*</sup> expresses a conclusion on historical financial information. Such engagements include audit and review engagements to report on a:

- Complete set of general purpose **financial statements**<sup>\*</sup>;
- Complete set of financial statements prepared in accordance with a framework designed for a special purpose;
- Single financial statement; and
- One or more specific elements, accounts or items of a financial statement.

The independence requirements in this section apply to all audit and review engagements. However, in limited circumstances involving certain **audit engagements**<sup>\*</sup> where the audit report is restricted for use by only the intended users specified in the report, the independence requirements in this section may be modified as provided in paragraphs 290.500 to 290.514.

Independence requirements for assurance engagements that are not audit or review engagements are addressed in Section 291.

290.2 In this section, the term(s):

- “Financial statements” includes other **historical financial information**<sup>\*</sup> when such information is the subject matter information of the engagement;
- “**Audit team**<sup>\*</sup>,” “audit engagement,” “**audit client**<sup>\*</sup>” and “audit report” includes review team, **review engagement**<sup>\*</sup>, **review client**<sup>\*</sup> and review report;
- “**Firm**<sup>\*</sup>” includes **network firm**<sup>\*</sup> except where otherwise stated; and
- “Entities of significant public interest” includes listed entities.

290.3 Compliance with the fundamental principle of objectivity is enhanced by being independent of audit clients. In the case of audit engagements, it is in the public interest and, therefore, required by this Code of Ethics, that members of audit teams, firms and network firms be independent of audit clients.

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<sup>\*</sup> See Definitions.

- 290.4 The objective of this section is to assist firms and members of audit teams in applying a conceptual approach to achieving and maintaining independence that involves:
- (a) Identifying threats to independence;
  - (b) Evaluating whether these threats are **clearly insignificant**\*; and
  - (c) When the threats are not clearly insignificant, identifying and applying safeguards to eliminate the threats or reduce them to an acceptable level.

Professional judgment should be used to determine the appropriate safeguards to eliminate any threats or reduce them to an acceptable level. If appropriate safeguards are not available, the audit engagement should be declined or terminated.

- 290.5 This section does not 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. Accordingly, firms should have policies and procedures, appropriately documented and communicated, to assign responsibility for (a) identifying and evaluating threats to independence and (b) applying appropriate safeguards to eliminate any threats or reduce them to an acceptable level.
- 290.6 This section concludes with some examples (paragraphs 290.100 onwards) of how the conceptual approach to independence is to be applied to specific circumstances and relationships. The examples are not intended to be all-inclusive.

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

- 290.7 Independence requires:

#### *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.

- 290.8 Many different circumstances, or combination of circumstances, may be relevant in assessing independence. Accordingly, it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action. A conceptual framework that requires firms and members of audit teams to identify, evaluate and address threats to independence rather than merely comply with a set of specific rules that may be arbitrary is, therefore, in the public interest.

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\* See Definitions.

290.9 In deciding whether to accept or continue an engagement, or whether a particular individual should be a member of the audit team, a firm should, therefore, evaluate the relevant circumstances and the threats to independence, and consider the availability of appropriate safeguards to eliminate the threat or reduce it to an acceptable level. The evaluation should be supported by information obtained before accepting the engagement and information that comes to the attention of the audit team during the engagement.

### **Networks and Network Firms**

290.10 If a firm is considered to be a network firm, the firm is required to be independent of the audit clients of the other firms within the **network**\* (unless otherwise stated). An entity that belongs to a network might be a firm, which is defined in this Code as a sole practitioner, partnership or corporation of professional accountants and an entity that controls or is controlled by such parties, or the entity might be another type of entity, such as a consulting practice or a professional law practice. The independence requirements in this section that apply to a network firm apply to any entity that meets the definition of a network firm irrespective of whether the entity itself meets the definition of a firm.

290.11 To enhance their ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is considered to be a network.

290.12 The judgment as to whether the larger structure is a network should be made 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 should be applied consistently throughout the network.

290.13 Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is considered to be a network. However, the sharing of immaterial costs would not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product would not in itself create a network.

290.14 Where the larger structure is aimed at cooperation and the entities within the structure share common ownership, control or management, it is considered to be a network. This could be achieved by contract or other means.

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\* See Definitions.

- 290.15 Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is considered to be a network. For this purpose common quality control policies and procedures would be those designed, implemented and monitored across the larger structure.
- 290.16 Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is considered to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not considered to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision of a professional service.
- 290.17 Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is considered to be a network. A common brand name includes common initials or a common name. A firm is considered to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an audit report.
- 290.18 Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms. Accordingly, a firm should carefully consider how it describes any such memberships in order to avoid the perception that it belongs to a network.
- 290.19 If a firm sells a component of its practice, the sales agreement sometimes provides that, for a limited period of time, the component may continue to use the name of the firm, or an element of the name, even though it is no longer connected to the firm. In such circumstances, while the two entities may be practicing under a common name, the facts are such that they do not belong to a larger structure aimed at co-operation and are, therefore, not network firms. Those entities should carefully consider how to disclose that they are not network firms when presenting themselves to outside parties.
- 290.20 Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is considered to be a network. Professional resources include:
- Common systems that enable firms to exchange information such as client data, billing and time records;
  - Partners and staff;
  - Technical departments to consult on technical or industry specific issues, transactions or events for assurance engagements;
  - Audit methodology or audit manuals; and
  - Training courses and facilities.

290.21 The determination of whether the professional resources shared are significant, and therefore the firms are network firms, should be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be considered to be significant. The same applies to a common training endeavor. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

### **Entities of Significant Public Interest**

290.22 Evaluating the significance of threats to independence and the safeguards necessary to eliminate them or reduce them to an acceptable level takes into account the extent of public interest in the entity. Entities of significant public interest are listed entities and certain other entities that, because of their business, size or number of employees, have a large number and wide range of stakeholders. The extent of the public interest in these entities is significant. This section, therefore, contains enhanced safeguards to recognize that interest.

290.23 In some countries, the entities considered to be of significant public interest for the purpose of determining the independence requirements that apply in that country are defined by law or regulation. In such cases, that definition should be used in applying the requirements in this section. In the absence of such a definition, member bodies should determine the types of entities that are of significant public interest and, thus, subject to the enhanced safeguards referred to above. Entities of significant public interest will always include listed entities, and, depending on the facts and circumstances, will normally include regulated financial institutions such as banks and insurance companies, and may include pension funds, government-agencies, government-controlled entities and not-for-profit entities.

### **Related Entities**

290.24 In the case of an audit client that is a **listed entity**<sup>\*</sup>, references to an audit client in this section include related entities of the client (unless otherwise stated). In the case of non-listed entities of significant public interest, references to audit client will, unless otherwise stated, generally include its related entities; in certain circumstances, depending on the nature and structure of the client's organization, it may not be necessary to apply the enhanced safeguards referred to above to all related entities to maintain independence from the audit client. This might be the case, for example, in the audit of a government-controlled entity.

290.25 For audit clients that are not entities of significant public interest, when the audit team knows or has reason to believe that a **related entity**<sup>\*</sup> of the client is relevant to the evaluation of the firm's independence from the client, the audit team should consider that related entity when evaluating threats to independence and applying appropriate safeguards.

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<sup>\*</sup> See Definitions.

### **Those Charged with Governance**

290.26 Even when not required by applicable auditing standards, law or regulation, regular communication is encouraged between the firm and **those charged with governance**<sup>\*</sup>, of the audit client regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence. Such communication enables those charged with governance to (a) consider the firm's judgments in identifying and evaluating threats to independence, (b) consider the appropriateness of safeguards applied to eliminate them or reduce them to an acceptable level, and (c) take appropriate action. Such an approach can be particularly helpful with respect to intimidation and familiarity threats.

### **Documentation**

290.27 Standards on quality control and auditing standards require documentation of matters important to the audit. Although documentation is not, in itself, a determinant of whether a firm is independent, when threats to independence that are not clearly insignificant are identified, and the firm decides to accept or continue the audit engagement, the decision should be documented. The documentation should describe the threats identified and the safeguards applied to eliminate them or reduce them to an acceptable level.

### **Engagement Period**

290.28 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, except when the engagement is of a recurring nature. In such a case 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.

290.29 When an entity becomes an audit client during or after the period covered by the financial statements on which the firm will express an opinion, 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 before accepting the audit engagement; or
- Previous services provided to the audit client.

290.30 If a non-assurance service was provided to the audit client during or after the period covered by the financial statements but before the commencement of professional services in connection with the audit and the service would be prohibited during the period of the audit engagement, consideration should be given to any threats to independence arising from the service. If the threat is not clearly insignificant, safeguards should be considered and applied when necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Obtaining the client's acknowledgement of responsibility for the results of the non-assurance service;

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<sup>\*</sup> See Definitions.

- Precluding personnel who provided the non-assurance service from being members of the audit team; or
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

**Other Considerations**

290.31 There may be occasions when there is an inadvertent violation of this section. If such an inadvertent violation occurs, it would generally not compromise independence with respect to the 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.

290.32 Throughout this section, reference is made to significant and clearly insignificant threats to 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.

**SECTION 290 OF THE CODE OF ETHICS**  
**INDEPENDENCE – AUDIT AND REVIEW ENGAGEMENTS**

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## Introduction

290.100 The following examples describe specific circumstances and relationships that may create threats to independence. The examples describe the potential threats 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 and the members of the audit 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 200.12 to 200.15 can be applied to satisfactorily address the threats to independence.

## Financial Interests

290.101 Holding a **financial interest**\* in an audit client may create a self-interest threat. In evaluating the significance of any threat, and the appropriate safeguards to be applied to eliminate it or reduce it to an acceptable level, it is necessary to evaluate the nature of the financial interest. This includes evaluating (a) the role of the person holding the financial interest, (b) the materiality of the financial interest and (c) whether the financial interest is direct or indirect.

290.102 When evaluating whether the financial interest is direct or indirect, 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 it holds (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 direct owner or trustee) or is able to influence investment decisions. In evaluating the significance of any threat to independence from an interest held through an investment vehicle, it is important to consider the nature of the financial interest and whether control can be exercised over the intermediary or its investment strategy. When control or the ability to influence investment decisions exists, the financial interest should be considered direct. Conversely, when the holder of the financial interest has no ability to exercise control or influence the investment decisions the financial interest should be considered indirect.

290.103 If a member of the audit team, an **immediate family**\* member, or a firm has a **direct financial interest**\* or a material **indirect financial interest**\* in the audit client, the self-interest threat would be so significant no safeguard could eliminate the threat or reduce it to an acceptable level. Therefore, none of the following should have a direct financial interest or a material indirect financial interest in the client: a member of the audit team; his or her immediate family member; or the firm.

290.104 When a member of the audit team knows that his or her **close family**\* member has a direct financial interest or a material indirect financial interest in the audit 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 audit team and the close family member and the materiality of the financial interest to the close family member. If

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\* See Definitions.

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:

- The close family member disposing, as soon as practicable, of all of the financial interest or disposing of a sufficient portion of an indirect financial interest so that the remaining interest is no longer material;
- Having a professional accountant perform an additional review of the work of the relevant member of the audit team; or
- Removing the individual from the audit team.

290.105 If a member of the audit team, his or her immediate family member, or a firm has a financial interest in an entity that has a controlling interest in the audit client, and the client is material to the entity, the self-interest threat would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, none of the following should have such a financial interest: a member of the audit team; his or her immediate family member; or the firm.

290.106 The holding by a firm's retirement benefit plan of a direct or material indirect financial interest in an audit client, may create a self-interest threat. The significance of any such threat should therefore 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.

290.107 If other partners in the **office**\* in which the **engagement partner**\* practices in connection with the audit engagement, or their immediate family members, hold a direct financial interest or a material indirect financial interest in that audit client, the self-interest threat would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, neither such partners nor their immediate family members should hold any such financial interests in such an audit client.

290.108 The office in which the engagement partner practices in connection with the audit engagement is not necessarily the office to which that partner is assigned. Accordingly, when the engagement partner is located in a different office from that of the other members of the audit team, judgment should be used to determine in which office the partner practices in connection with that engagement.

290.109 If other partners and managerial employees who provide non-audit services to the audit client, except those whose involvement is clearly insignificant, or their immediate family members, hold a direct financial interest or a material indirect financial interest in the audit client, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, neither such personnel nor their immediate family members should hold any such financial interests in such an audit client.

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\* See Definitions.

290.110 Despite paragraphs 290.107 and 290.109, the holding of a financial interest in an audit client by an immediate family member of (a) a partner located in the office in which the engagement partner practices in connection with the audit engagement, or (b) a partner or managerial employee who provides non-audit services to the audit client, is not considered to compromise independence if the financial interest is received as a result of his or her employment rights (e.g., pension rights or share options) and appropriate safeguards, when necessary, are applied to eliminate any threat to independence or reduce it to an acceptable level. However when the immediate family member has or obtains the right to dispose of the financial interest or, in the case of a stock option, the right to exercise the option, the financial interest should be disposed of or forfeited as soon as practicable.

290.111 A self-interest threat may be created if the firm or a member of the audit team, or his or her immediate family member, has a financial interest in an entity and an audit client, or one of its directors, officers or controlling owners also has a financial interest in that entity. Independence is not compromised if these interests are immaterial and the audit client cannot exercise significant influence over the entity. If such interest is material to any party, and the audit client can exercise significant influence over the other entity, no safeguards could reduce the threat to an acceptable level and the firm should either dispose of the interest or the firm should decline the audit engagement. Any individual with such a material interest should, before becoming a member of the audit team, either:

- (a) Dispose of the interest; or
- (b) Dispose of a sufficient amount of the interest so that the remaining interest is no longer material.

290.112 The holding by a firm or a member of the audit team, or his or her immediate family member, of a direct financial interest or a material indirect financial interest in the audit client as a trustee, may create a self-interest threat. Accordingly, such an interest should only be held when:

- Neither the member of the audit team, nor the immediate family member, nor the firm are beneficiaries of the trust;
- The interest held by the trust in the audit client is not material to the trust;
- The trust is not able to exercise significant influence over the audit client; and
- The member of the audit team, the immediate family member, or the firm does not have significant influence over any investment decision involving a financial interest in the audit client.

Similarly a self-interest threat may be created when (a) a partner in the office in which the engagement partner practices in connection with the audit, (b) other partners and managerial employees who provide non-assurance services to the audit client, except those whose involvement is clearly insignificant, or (c) their immediate family members, hold a direct financial interest or a material indirect financial interest in the audit client as trustee. Accordingly such an interest should only be held under the conditions noted above.

290.113 Consideration should be given by members of the audit team to whether a self-interest threat may be created by any known financial interests in the audit client held by other individuals including:

- Partners and professional employees of the firm, other than those referred to above, or their immediate family members; and
- Individuals with a close personal relationship with a member of the audit team.

Whether these interests create a self-interest threat will depend on 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 audit team.

The significance of any 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:

- Removing the member of the audit team with the personal relationship from the audit team;
- Excluding the member of the audit team from any significant decision-making concerning the audit engagement; or
- Having a professional accountant perform an additional review of the work of the relevant member of the audit team.

290.114 If a firm or a partner or employee of the firm or his or her immediate family member, receives a direct financial interest or a material indirect financial interest in an audit client, for example by way of an inheritance, gift or, as result of a merger, and such interest would not be permitted to be held under this section, then:

- (a) If the interest is received by the firm, the financial interest should be disposed of immediately, or a sufficient amount of an indirect financial interest should be disposed of so that the remaining interest is no longer material, or the firm should withdraw from the audit engagement;
- (b) If the interest is received by a member of the audit team, or his or her immediate family member, the individual should immediately dispose of the financial interest, or dispose of a sufficient amount of an indirect financial interest so that the remaining interest is no longer material, or the individual should be removed from the team; or
- (c) If the interest is received by an individual who is not a member of the audit team, or by his or her immediate family member, the individual should dispose of the financial interest as soon as possible, or dispose of a sufficient amount of an indirect financial interest so that the remaining interest is no longer material. Pending the disposal of the financial interest, consideration should be given to whether any safeguards are necessary.

290.115 An inadvertent violation of this section as it relates to a financial interest in an audit client would not compromise independence as long as:

- (a) The firm has established policies and procedures that require all professionals to promptly report to the firm any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the audit client;
- (b) In the case of a purchase by an individual, the individual is advised that the financial interest should be disposed of and the disposal takes place as soon as possible after the identification of the issue or in other circumstances the actions prescribed in paragraph 290.114 are taken;
- (c) In the case of a purchase by the firm, the disposal takes place immediately after the identification of the issue; and
- (d) The firm considers whether any other safeguards should be applied. Such safeguards might include:
  - Involving an additional professional accountant to review the work of the member of the audit team; or
  - Excluding the individual from any significant decision-making concerning the audit engagement.

In addition, consideration should be given to discussing the matter with those charged with governance.

### **Loans and Guarantees**

290.116 A loan, or a guarantee of a loan, to the firm, or a member of the audit team, from an audit client that is a bank or a similar institution, may create a threat to independence. If the loan or guarantee is not made under normal lending procedures, terms and conditions the self-interest threat would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, neither a firm nor a member of the audit team should accept such a loan or guarantee.

### **Close Business Relationships**

290.117 If a loan to a firm is made under normal lending procedures, terms and conditions and it is material to the audit client, or firm receiving the loan, it may be possible to apply safeguards to reduce the self-interest threat to an acceptable level. Such safeguards might include a review of the work by an additional professional accountant from a network firm that is not involved with the audit and did not receive the loan.

290.118 A loan, or a guarantee of a loan, from an audit client that is a bank or a similar institution to a member of the audit team, or his or her immediate family member would not create a threat to independence if the loan or guarantee is made under normal lending procedures, terms and conditions. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.

290.119 If the firm, or a member of the audit team, or his or her immediate family member, makes or guarantees a loan to an audit client the self-interest threat would be so significant that no safeguards could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the audit team, or the immediate family member, and the client. However, deposits made by, or brokerage accounts of, a firm or member of the audit team, or his or her immediate family member, with an audit client that is a bank, broker or similar institution would not create a threat to independence if the deposit or account is held under normal commercial terms.

290.120 Similarly, if the firm or a member of the audit team, or his or her immediate family member, accepts a loan from, or has a borrowing guaranteed by, an audit client that is not a bank or similar institution, the self-interest threat would be so significant that no safeguards could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the audit team, or the immediate family member, and the client.

### **Close Business Relationships**

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

- Having a financial interest in a joint venture with either the 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 client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm distributes or markets the client's products or services, or the client distributes or markets the firm's products or services.

Unless any financial interest is immaterial and the relationship is clearly insignificant to the firm and the client or its management, no safeguards could reduce the threat to an acceptable level. If the magnitude of the relationship cannot be reduced so that the financial interest is immaterial and the relationship is clearly insignificant:

- (a) The business relationship should be terminated; or
- (b) The firm should refuse to perform the audit engagement.

In the case of a member of the audit team, unless any such financial interest is immaterial and the relationship is clearly insignificant to that member, the individual should be removed from the audit team.

If the close business relationship is between an immediate family member of a member of the audit team and the audit client or its management, 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.

290.122 A business relationship involving the holding of an interest by the firm, or a member of the audit team, or his or her immediate family member, 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, does not create threats to independence if:

- (a) The relationship is clearly insignificant to the firm, the member of the audit team, or his or her immediate family member and the client;
- (b) The interest 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.

290.123 The purchase of goods and services from an audit client by the firm, or member of the audit team, or his or her immediate family member, would not generally create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions may be of such a nature or magnitude that they create a self-interest threat. 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:

- Eliminating or reducing the magnitude of the transaction; or
- Removing the individual from the audit team.

### **Family and Personal Relationships**

290.124 Family and personal relationships between a member of the audit team and a director, officer or certain employees (depending on their role) of the audit client, may create self-interest, familiarity or intimidation threats. The significance of any threats will depend on a number of factors, including the individual's responsibilities on the audit team, the closeness of the relationship and the role of the family member or other individual within the client. Consequently, the particular circumstances will need to be evaluated in assessing the significance of these threats.

290.125 When an immediate family member of a member of the audit team is:

- (a) A director or an officer of the audit client; or
- (b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion

or was in such a position during any period covered by the engagement or the financial statements, the threats to independence can only be reduced to an acceptable level by removing the individual from the audit team. The closeness of the relationship is such that

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\* See Definitions.

no other safeguard could reduce the threat to an acceptable level. If this safeguard is not applied, the firm should withdraw from the audit engagement.

290.126 Threats to independence may be created when an immediate family member of a member of the audit team is an employee in a position to exert significant influence over the client's financial position, financial performance or cash flows. The significance of the threats will depend on factors such as:

- The position held by the immediate family member; and
- The role of the professional on the audit team.

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:

- Removing the individual from the audit team; or
- Structuring the responsibilities of the audit team so that the professional does not deal with matters that are within the responsibility of the immediate family member.

290.127 Threats to independence may be created when a close family member of a member of the audit team is:

- (a) A director or an officer of the audit client; or
- (b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

The significance of the threats will depend on factors such as:

- The nature of the relationship between the member of the audit team and his or her close family member;
- The position held by the close family member; and
- The role of the professional on the audit team.

The significance of any 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:

- Removing the individual from the audit team; or
- Structuring the responsibilities of the audit team so that the professional does not deal with matters that are within the responsibility of the close family member.

290.128 Threats to independence may be created when a person who is other than an immediate or close family member of a member of the audit team has a close relationship with the member of the audit team and is a director or an officer or an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial

statements on which the firm will express an opinion. The significance of the threats will depend on factors such as:

- The nature of the relationship between the individual and the member of the audit team;
- The position the individual holds with the client; and
- The role of the professional on the audit team.

Members of the audit team are responsible for identifying any such persons and for consulting in accordance with firm policies and procedures. The significance of any 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:

- Removing the professional from the audit team; or
- Structuring the responsibilities of the audit team so that the professional does not deal with matters that are within the responsibility of the individual with whom he or she has a close relationship.

290.129 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 audit team and a director or an 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 on which the firm will express an opinion. The significance of any threat will depend on factors such as:

- The nature of the relationship between the partner or employee of the firm and the director, officer or employee of the client;
- The interaction of the partner or employee of the firm with the audit team;
- The position of the partner or employee within the firm; and
- The role of the individual within the client.

Partners and employees of the firm are responsible for identifying any such relationships and for consulting in accordance with firm policies and procedures. The significance of any 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:

- Structuring the partner's or employee's responsibilities to reduce any potential influence over the audit engagement; or
- Having another professional accountant review the relevant audit work or otherwise advise as necessary.

290.130 An inadvertent violation of this section as it relates to family and personal relationships would not compromise independence if:

- (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) The inadvertent violation relates to an immediate family member of a member of the audit team becoming a director or an 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 on which the firm will express an opinion, the relevant professional is removed from the audit team; and
- (c) The firm considers and applies as appropriate other safeguards. Such safeguards might include:
  - Having an additional professional accountant review the work of the member of the audit team; or
  - Excluding the relevant professional from any significant decision-making concerning the engagement.

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

290.131 Self-interest, familiarity or intimidation threats may be created if a director or an 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 on which the firm will express an opinion, has been a member of the audit team or partner of the firm. This would be particularly the case when significant connections remain between the individual and his or her former firm.

290.132 If a member of the audit team, partner or former partner of the firm has joined the audit client in such a position, the significance of the self-interest, familiarity or intimidation threats will depend on factors such as:

- (a) The position the individual has taken at the client;
- (b) Any involvement the individual will have with the audit team;
- (c) The length of time since the individual was a member of the audit team or firm; and
- (d) The former position of the individual within the audit team or firm, such as for example, whether the individual was responsible for maintaining regular contact with management or those charged with governance.

In all cases the following safeguards are necessary to ensure that no significant connection remains between the firm and the individual:

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

The significance of any remaining threat should be evaluated and if it 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:

- Modifying the audit plan;
- Assigning an audit team that is of sufficient experience in relation to the individual who has joined the client; or
- Having an additional professional accountant review the work or otherwise advise as necessary.

290.133 If a former partner of the firm has previously joined an entity in such a position and the entity subsequently becomes an audit client of the firm, any threats to independence should be evaluated and if the threats are not clearly insignificant, safeguards should be considered and applied, when necessary, to eliminate the threat or reduce it to an acceptable level.

290.134 A self-interest threat is created when a member of the audit team participates in the audit engagement while knowing that he or she will, or may, join the client some time in the future. Firm policies and procedures should require members of an audit team to notify the firm when entering employment negotiations with the client. On receiving such notification 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:

- (a) Removal of the individual from the audit team; or
- (b) A review of any significant judgments made by that individual while on the team.

*Audit Clients of Significant Public Interest*

290.135 Self-interest, familiarity or intimidation threats will be created if a **key audit partner**\* joins an audit client that is an entity of significant public interest:

- (a) In a position to exert significant influence over the preparation of the entity's accounting records or its financial statements; or
- (b) As a director or an officer of the entity.

No safeguards could eliminate these threats or reduce them to an acceptable level unless the entity of significant public interest had issued audited financial statements covering a period of not less than twelve months for which the partner was not a member of the audit team during any part of the period.

290.136 An intimidation threat will be created if the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent) joins an audit client of the firm that is an entity of significant public interest (a) in a position to exert significant influence over the preparation of the entity's accounting records or its financial statements or (b) as a director or an officer of the entity. No safeguards could eliminate these threats or reduce them to an

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\* See Definitions.

acceptable level unless twelve months have passed since the individual was the Senior or Managing Partner (Chief Executive or equivalent) of the firm.

290.137 If, as a result of a business combination, a former key audit partner or former chief executive of the firm is in a position as described in paragraphs 290.135 and 290.136, the threats to independence are not considered unacceptable if:

- (a) The position was not taken in contemplation of the business combination;
- (b) Any benefits or payments due to the 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 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 partner with the audit client is discussed with those charged with governance.

### **Temporary Staff Assignments**

290.138 The lending of staff by a firm to an audit client may create a self-review threat. In practice, such assistance may be given, but only on the understanding that the assistance should only be for a short period of time and the firm's personnel will not be involved in:

- Providing non-assurance services that would not be permitted under this section; or
- Performing management functions.

In all circumstances, the audit client should acknowledge its responsibility for directing and supervising the activities of loaned staff.

The significance of any 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:

- Conducting an additional review of the work performed by the loaned staff; and
- Not giving the loaned staff audit responsibility for any function or activity that they performed during their temporary staff assignment.

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

290.139 Self-interest, self-review or familiarity threats may be created if a former director, officer or employee of the audit client serves as a member of the audit team. This would be particularly the case when, for example, a member of the audit team has to evaluate elements of the financial statements for which he or she had prepared the accounting records while with the client.

290.140 If, during the period covered by the audit report, a member of the audit team had served as a director or an officer of the audit client, or as an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial

statements on which the firm will express an opinion, 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 audit team.

290.141 Self-interest, self-review or familiarity threats may be created if, before the period covered by the audit report, a member of the audit team had served as a director or an officer of the audit client, or as an employee in a position to exert significant influence over the preparation of the client's accounting records or financial statements on which the firm will express an opinion. 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 client, is to be evaluated in the current period as part of the current audit engagement. The significance of the threats will depend on factors such as:

- The position the individual held with the client;
- The length of time since the individual left the client; and
- The role of the professional on the audit team.

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 reduce the threat to an acceptable level. Such safeguards might include conducting an additional review of the work performed by the individual as part of the audit team.

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

290.142 If a partner or employee of the firm serves at the same time as a director or an officer of an audit client, the self-review and self-interest threats would be so significant that no safeguards could reduce the threats to an acceptable level. Therefore, if such an individual were to accept such a position the firm should decline or withdraw from the audit engagement.

290.143 The position of Company Secretary has different implications in different jurisdictions. 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.

290.144 If a partner or employee of the firm serves as Company Secretary for an audit client, the self-review and advocacy threats would generally be so significant, that no safeguards could reduce the threat to an acceptable level. When this practice is specifically permitted under local law, professional rules or practice, the duties and functions should be limited to those of a routine and administrative nature such as preparing minutes and maintaining statutory returns. Further, management should make all relevant decisions. The significance of any threat should be evaluated and, if not clearly insignificant, safeguards should be applied to eliminate the threat or reduce it to an acceptable level.

290.145 Performing routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters will not generally be perceived to compromise independence, as long as client management makes all relevant decisions.

### **Long Association of Senior Personnel (Including Partner Rotation)**

#### *General Provisions*

290.146 Familiarity, self-review or self-interest threats may be created by using the same senior personnel on an audit engagement over a long period of time. The significance of the threat will depend on factors such as:

- How long the individual has been a member of the audit team;
- The role of the individual on the audit team;
- The structure of the firm;
- The nature of the audit engagement;
- Whether the client's management team has changed; and
- Whether the nature or complexity of the client's accounting and reporting issues has changed.

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:

- Rotating the senior personnel off the audit team;
- Having an additional professional accountant who was not a member of the audit team review the work of the senior personnel; or
- Regular independent internal or external quality reviews of the engagement.

#### *Audit Clients of Significant Public Interest*

290.147 In respect of the audit of entities of significant public interest, an individual should not be a key audit partner for more than seven years. After such a time, the individual should not return to the **engagement team**\* or be a key audit partner for the client for two years. During that period, the individual should not participate in the audit of the entity.

290.148 Despite paragraph 290.147, key audit partners whose continuity is especially important to audit quality may in rare cases, due to external and unforeseen circumstances, be permitted an additional year on the audit team as long as any threat to independence that is not clearly insignificant can be eliminated or reduced to an acceptable level by applying safeguards. For example, a partner may remain on the audit team for up to one additional year in circumstances where, due to unforeseen events, a required rotation was not possible, as might be the case due to serious illness of the intended engagement partner.

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\* See Definitions.

290.149 The long association of other partners with an audit client that is an entity of significant public interest may create a familiarity threat, a self-review threat or self-interest threat. The significance of the threat will depend on factors such as:

- How long any such partner has been associated with the audit client;
- The role, if any, of the individual on the audit team; and
- The nature, frequency, and extent of the individual's interactions with the client, its board or those charged with governance.

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:

- Rotating the partner off the audit team; or
- Regular independent internal or external quality reviews of the engagement.

290.150 When an audit client becomes an entity of significant public interest, the length of time the individual has served the audit client as a key audit partner before the client becomes an entity of significant public interest should be considered in determining when the individual should be rotated. If the individual has served the audit client as a key audit partner for five years or less when the client becomes an entity of significant public interest, the number of years the individual may continue to serve the client in that capacity before rotating off the engagement is seven years less the number of years already served. If the individual has served the audit client as a key audit partner for six or more years when the client becomes an entity of significant public interest, the partner may continue to serve in that capacity for two additional years before rotating off the engagement.

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

290.151 Firms have traditionally provided to their audit clients a range of non-assurance services that are consistent with their skills and expertise. Providing non-assurance services may, however, create threats to the independence of the firm or the members of the audit team. New developments in business, the evolution of financial markets and changes in information technology make it impossible to draw up an all-inclusive list of non-assurance services that might be provided to an audit client.

290.152 Before the firm accepts an engagement to provide a non-assurance service to an audit client, consideration should be given to whether providing such a service would create a threat to independence. In evaluating the significance of any threat created by a particular non-assurance service, consideration should be given to any threat that the audit team has reason to believe may be created by providing other related non-assurance services. In some cases it may be possible to eliminate or reduce the threat created by the application of safeguards. In other cases no safeguards could reduce the threat to an acceptable level; accordingly the non-assurance service should not be provided.

- 290.153 Providing certain non-assurance services to an audit client may create a threat to independence so significant that no safeguards could eliminate the threat or reduce it to an acceptable level. However, the inadvertent provision of such a service to a related entity, division or in respect of a discrete financial statement item of such clients may not compromise independence if any threats that are not clearly insignificant 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.
- 290.154 A firm may be able to provide certain non-assurance services to related entities of the audit client if the firm is able to reasonably conclude that the results of the services will not be subject to audit procedures and consequently do not create a self-review threat. This would be the case if the firm provides certain non-assurance services to:
- (a) An entity, that is not an audit client, that has direct or indirect control over the audit client; or
  - (b) An entity, that is not an audit client, that is under common control with the audit client.
- 290.155 A non-assurance service provided to an audit client will not compromise the firm's independence when the client becomes an entity of significant public interest if:
- (a) The previous non-assurance service complies with the provisions of this section that relate to audit clients that are not entities of significant public interest;
  - (b) Services that are not permitted under this section for audit clients that are entities of significant public interest are terminated before or as soon as practicable after the client becomes an entity of significant public interest; and
  - (c) The firm implements appropriate safeguards to eliminate or reduce to an acceptable level any threats to independence that are not clearly insignificant arising from the service.

### **Management Responsibilities**

- 290.156 Management of an entity performs many functions in managing the entity in the best interests of stakeholders of the entity. It is not possible to specify every function that is a management responsibility. However, management functions involve leading and directing an entity including making significant decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources.
- 290.157 Whether an activity is a management function depends on the circumstances and requires the exercise of judgment. Examples of activities that would generally be considered management functions include:
- Setting policies and strategic direction;
  - Authorizing transactions;

- Deciding which recommendations of the firm or other third parties should be implemented;
- 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.

290.158 Performing management functions for an audit client creates threats to independence. For example, deciding which recommendations of the firm should be implemented will create self-review and self-interest threats. Further, performing management functions creates a familiarity threat because the firm becomes too closely aligned with the views and interests of management. If a firm performs management functions for an audit client, no safeguards could reduce the threats to an acceptable level. Accordingly, a firm that provides professional services to an audit client should not perform management functions.

290.159 Some activities may not be management functions because they are routine and administrative, involve matters that are insignificant or do not otherwise represent a management responsibility. For example, executing an insignificant transaction that has been authorized by management or monitoring the dates for filing statutory returns and advising an audit client of those dates would not be considered management functions. Further, providing advice and recommendations to assist management in performing its functions or providing elements of a client's internal training program would not be considered a management function.

290.160 To avoid the risk of performing management functions when providing non-assurance services to an audit client, the firm should be satisfied that a member of management with a sufficient level of understanding of the service, and an ability to evaluate the results, has been designated to make all significant judgments and decisions connected with the services, and to accept responsibility for the actions to be taken arising from the results of the service. This reduces the risk of the firm inadvertently making any significant judgment or decision on behalf of management. The risk is further reduced when the firm gives the client the opportunity to make judgments and decisions based on an objective and transparent analysis and presentation of the issues.

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

290.161 Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework. These responsibilities include:

- Determining or changing journal entries, or the account classifications of transactions; and
- Preparing or changing 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).

- 290.162 Providing an audit client with accounting and bookkeeping services such as preparing accounting records or financial statements may create a self-review threat when the firm subsequently audits the financial statements.
- 290.163 The audit process, however, necessitates extensive dialogue between the firm and management of the audit client. Management may request and receive technical assistance and advice from members of the audit team regarding such matters as (a) implementation of new accounting standards or policies and financial statement disclosure requirements, or (b) the appropriateness of financial and accounting controls and the methods used in determining the stated amounts of assets and liabilities. Assistance and advice of this nature promotes the fair presentation of the client's financial statements and accordingly does not generally threaten the firm's independence.
- 290.164 Similarly, the client may request the firm to assist in (a) resolving account reconciliation problems, (b) analyzing and accumulating information for regulatory reporting, (c) converting financial statements from one financial reporting framework to another (for example, to comply with group accounting policies or to transition to a different financial reporting framework such as International Financial Reporting Standards), or (d) drafting disclosure items and proposing adjusting journal entries. These activities are considered to be a normal part of the audit process and do not, generally, threaten independence.

*Audit Clients that are Not Entities of Significant Public Interest*

- 290.165 The firm may provide services related to the preparation of accounting records and financial statements for an audit client that is not an entity of significant public interest where the services are of a routine or mechanical nature, so long as any self-review threat created is reduced to an acceptable level. Examples of such services include:
- Providing payroll services based on client-originated data;
  - Recording transactions for which the client has determined or approved the appropriate account classification;
  - Posting transactions coded by the client to the client's general ledger;
  - Posting client-approved entries to the trial balance; and
  - Preparing financial statements based on information in the trial balance.

In all cases the significance of any threat created 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:

- Arranging for such services to be performed by an individual who is not a member of the audit team; or
- If such services are performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to conduct an additional review of the work performed.

*Audit Clients that are Entities of Significant Public Interest*

290.166 Except in emergency situations, a firm should not provide to an audit client that is an entity of significant public interest accounting and bookkeeping services, including payroll services, or prepare financial statements on which the firm will express an opinion or financial information which forms the basis of the financial statements.

290.167 Despite paragraph 290.166, a firm may provide accounting and bookkeeping services, including payroll services and the preparation of financial statements, of a routine or mechanical nature for divisions or related entities of an audit client that is of significant public interest 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.

*Emergency Situations*

290.168 Accounting and bookkeeping services, that would otherwise not be permitted under this section may be provided to audit clients in emergency or other unusual situations, when it is impractical for the audit client to make other arrangements such as where only the firm has the resources and necessary knowledge of the client's systems and procedures to assist the client in the timely preparation of its accounting records and financial statements and where a restriction on the firm's ability to provide the services would result in significant difficulties for the client (for example, as might result from a failure to meet regulatory reporting requirements). In such situations, a firm may provide such services, if:

- (a) Those who provide the services are not members of the audit team; and
- (b) The services are provided for only a short period of time and are not expected to recur.

**Valuation Services**

290.169 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.

290.170 Performing valuation services for an audit client may create a self-review threat. The significance of the threat will depend on factors such as:

- (a) The extent to which the valuation will have a material effect on the financial statements.
- (b) The extent of the client's involvement in determining and approving the valuation methodology and other significant matters of judgment.
- (c) The availability of established methodologies and professional guidelines.

- (d) For valuations involving standard or established methodologies, the degree of subjectivity inherent in the item.
- (e) The reliability and extent of the underlying data.
- (f) The degree of dependence on future events of a nature that could create significant volatility inherent in the amounts involved.
- (g) The extent and clarity of the disclosures in the financial statements.

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; or
- Making arrangements so that personnel providing such services do not participate in the audit engagement.

290.171 If the valuation service has a material effect on the financial statements on which the firm will express an opinion and the valuation involves a significant degree of subjectivity, no safeguard could reduce the self-review threat to an acceptable level. Accordingly, the firm should either not provide the valuation service or should withdraw from the audit engagement.

290.172 Certain valuations do not involve a significant degree of subjectivity. This is likely the case where the underlying assumptions are either determined by law or regulation, or are widely accepted and when the techniques and methodologies to be used are based on generally accepted standards or prescribed by law or regulation. In such circumstances, the results of a valuation performed by two or more parties are not likely to be materially different.

#### *Audit Clients that are Entities of Significant Public Interest*

290.173 A firm should not provide valuation services to an audit client that is an entity of significant public interest if the valuations would have a material effect, separately or in the aggregate, on the financial statements on which the firm will express an opinion.

#### **Taxation Services**

290.174 Taxation services comprise a broad range of services, including:

- Tax return preparation;
- Preparation of tax calculations intended to be used as the basis for the accounting entries in the financial statements;
- Tax planning and other tax advisory services; and
- Assistance in the resolution of tax disputes

While taxation services provided by a firm to an audit client are considered separately under each of these broad headings, in practice these activities are often interrelated.

290.175 Performing certain tax services may create self-review and advocacy threats. The nature and significance of any threats will depend on factors such as (a) the system by which the tax authorities assess and administer the tax in question, (b) the complexity of the relevant tax regime and the degree of judgment necessary in applying it (c) the particular characteristics of the engagement and (d) the level of tax expertise of the client's employees.

#### *Tax Return Preparation*

290.176 Tax return preparation services involve assisting clients with their tax reporting obligations by drafting and completing information, including the amount of tax due (usually on standardized forms) required to be submitted to the applicable tax authorities. Such services also include advising on the tax return treatment of past transactions and responding on behalf of the audit client to the tax authorities' requests for further information and analysis (including providing explanations of and technical support for the approach being taken). Tax return preparation services are generally based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice. Further, the tax returns are subject to whatever review or approval process the tax authority considers appropriate. Accordingly, providing such services does not generally threaten the firm's independence so long as management takes responsibility for the returns including any significant judgments made.

#### *Preparation of Tax Calculations to be Used as the Basis for the Accounting Entries in the Financial Statements*

290.177 Preparing calculations of current and deferred tax liabilities (or assets) for an audit client for the purpose of the preparation of accounting entries that will be subsequently audited by the firm may create a self-review threat. The significance of the threat created will depend on the degree of subjectivity involved in the calculations and their materiality to the financial statements. If the self-review threat created 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:

- Using professionals who are not members of the audit team to perform the service; or
- If the service is performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the tax calculations.

#### *Audit Clients that are Entities of Significant Public Interest*

290.178 In the case of an audit client that is an entity of significant public interest, a firm should not prepare tax calculations of current and deferred tax liabilities (or assets) for the primary purpose of preparing accounting entries that are material to the financial statements on which the firm will express an opinion.

*Tax Planning and Other Tax Advisory Services*

290.179 Tax planning or other tax advisory services comprise a broad range of services such as advising the client how to structure its affairs in a tax efficient manner or advising on the application of a new tax law or regulation.

290.180 A self-review threat may be created where the advice will affect matters to be reflected in the financial statements. The significance of any threat will depend on factors such as:

- The degree of subjectivity involved in determining the appropriate treatment for the tax advice in the financial statements;
- The extent to which the outcome of the tax advice will have a material effect on the financial statements;
- The level of tax expertise of the client's employees;
- The extent to which the advice is supported by tax law or regulations, other precedent or established practice;
- Whether the tax treatment is supported by a private ruling or has otherwise been cleared by the tax authority before the preparation of the financial statements; and
- Whether the effectiveness of the tax advice depends on the accounting treatment or presentation in the financial statements and there is doubt as to the appropriateness of the accounting treatment or presentation under the relevant financial reporting framework.

For example, providing tax planning and other tax advisory services where the advice is clearly supported by tax authority or other precedent, by established practice or has a basis in tax law that is likely to prevail does not generally threaten the firm's independence.

290.181 The significance of any 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:

- Using professionals who are not members of the audit team to perform the service;
- Having an additional tax partner or senior tax employee, not involved in the provision of tax services, advise the audit team on the service and review the financial statement treatment; or
- Obtaining advice on the service from an external tax professional.

290.182 Where the effectiveness of the tax advice depends on a particular accounting treatment or presentation in the financial statements and:

- (a) There is 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 tax advice will have a material effect on the financial statements;

the self-review threat would be so significant that no safeguards could reduce the threat to an acceptable level in which case the tax advice should not be provided. The only other course of action would be to withdraw from the audit engagement.

*Assistance in the Resolution of Tax Disputes*

290.183 An advocacy threat may be created when the firm represents an audit client in the resolution of a tax dispute once the tax authorities have made it known that they have rejected the audit client's arguments on a particular issue and are referring the matter for determination in a formal proceeding, for example before a tribunal or court. The significance of the threat will depend on factors such as:

- Whether the firm has provided the advice which is the subject of the tax dispute;
- The extent to which the outcome of the dispute will have a material effect on the financial statements on which the firm will express an opinion;
- The extent to which the matter is supported by tax law or regulations, other precedent, or established practice;
- Whether the proceedings are conducted in public; and
- The role management plays in the resolution of the dispute.

The significance of any 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:

- Using professionals who are not members of the audit team to perform the service;
- Having an additional tax partner or senior tax employee who is not involved in the provision of the tax services to the client advise the audit team on the services and review the financial statement treatment; or
- Obtaining advice on the service from an external tax professional.

290.184 Where the taxation services involve acting as an advocate for an audit client before a public tribunal or court in the resolution of a tax matter and the amounts involved are material to the financial statements, the advocacy threat is considered so significant that no safeguard could eliminate or reduce the threat to an acceptable level. Therefore, the firm should not perform this type of service for an audit client. What constitutes a "public tribunal or court" should be determined according to how tax proceedings are heard in the particular jurisdiction.

290.185 The firm is not, however, precluded from having a continuing advisory role (for example, responding to specific requests for information, providing factual accounts or testimony about the work performed or assisting the client in analyzing the tax issues) for the audit client in relation to the matter that is being heard before a public tribunal or court.

### **Internal Audit Services**

- 290.186 A self-review threat may be created when a firm provides internal audit services to an audit client. Internal audit services may comprise (a) an extension of the firm's audit service beyond requirements of generally accepted auditing standards, (b) assistance in performing a client's internal audit activities or (c) 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.
- 290.187 Services involving an extension of the procedures required to conduct an audit in accordance with International Standards on Auditing would not be considered to compromise independence with respect to the audit client if the firm's personnel do not perform management functions.
- 290.188 When the firm provides assistance in the performance of an audit client's internal audit activities or undertakes the outsourcing of some of the activities, any self-review threat may be reduced to an acceptable level by ensuring there is a clear separation between the management and control of the internal audit by client management and the internal audit activities themselves.
- 290.189 Performing a significant portion of an audit client's internal audit activities may create a self-review threat. A firm should consider the threats and proceed with caution. Appropriate safeguards should be put in place and the firm should, in particular, ensure that the audit client acknowledges its responsibilities for establishing, maintaining and monitoring the system of internal controls.
- 290.190 A firm should not provide any internal audit services to an audit client unless:
- (a) The client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the system of internal controls;
  - (b) The client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;
  - (c) The client or those charged with governance approve the scope, risk and frequency of internal audit work;
  - (d) The client is responsible for evaluating and determining which recommendations of the firm to implement;
  - (e) The client evaluates the adequacy of the internal audit procedures and the findings resulting from their performance 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 those charged with governance.

290.191 Consideration should also be given to whether such non-assurance services should be provided only by personnel who are not members of the audit team and who have different reporting lines within the firm.

### **IT Systems Services**

290.192 Services related to information technology (IT) systems include the design or implementation of hardware or software systems. The systems may aggregate source data or generate information that affects the accounting records or financial statements or the systems may be unrelated to the audit client's accounting records or financial statements. Providing systems services may create a self-review threat depending on the nature of the services and the IT systems.

290.193 Certain IT systems services are not considered to create a threat to independence as long as firm personnel do not perform management functions. Such services include the following:

- Design or implementation of IT systems that are unrelated to or do not form a significant part of the accounting records or financial statements;
- 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
- Evaluating and making recommendations with respect to a system designed, implemented or operated by another service provider or the client.

### *Audit Clients that are Not Entities of Significant Public Interest*

290.194 Providing services to an audit client that is not an entity of significant public interest involving the design or implementation of IT systems that (a) form a significant part of the accounting systems or (b) generate information that is significant to the client's financial statements on which the firm will express an opinion may create a self-review threat.

290.195 The self-review threat is likely to be too significant to permit such services unless appropriate safeguards are put in place ensuring that:

- (a) The client acknowledges its responsibility for establishing and monitoring a system of internal controls;
- (b) The client assigns the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system to a competent employee, preferably within senior management;
- (c) The client makes all management decisions with respect to the design and implementation process;
- (d) The client evaluates the adequacy and results of the design and implementation of the system; and
- (e) The client is responsible for operating the system (hardware or software) and the data it uses or generates.

290.196 Depending on the degree of reliance that will be placed on the particular IT systems as part of the audit, consideration should also be given to whether, such non-assurance services should be provided only by personnel who are not members of the audit team and who have different reporting lines within the firm. The significance of any remaining threat should be evaluated and if it 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*

290.197 In the case of an audit client that is an entity of significant public interest, a firm should not provide services involving the design or implementation of IT systems that form a significant part of the accounting systems or generate information that is significant to the client's financial statements on which the firm will express an opinion.

**Litigation Support Services**

290.198 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.

290.199 If the firm provides a litigation support service to an audit client and the service involves estimating damages or other amounts that affect the financial statements on which the firm will express an opinion the valuation service provisions included in paragraphs 290.169 to 290.173 should be followed.

290.200 If the litigation support services relate to activities other than estimating damages or other amounts, the significance of any threat created 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.

**Legal Services**

290.201 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. 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 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.

290.202 Legal services that support an audit client in executing a transaction (e.g., contract support, legal advice, legal due diligence and restructuring) may create self-review threats. The significance of the threat will depend on factors such as:

- The nature of the service;

- Whether the service is provided by a member of the audit team; and
- The materiality of any matter in relation to the client's financial statements.

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:

- Using professionals who are not members of the audit team to perform the service; or
- Having an additional partner or senior employee, not involved in providing the legal services, provide advice to the audit team on the service and review any financial statement treatment.

290.203 Acting for an audit client in resolving a dispute or litigation when the amounts involved are material in relation to the financial statements of the 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 audit client.

290.204 When a firm is asked to act 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 of the client, the firm should evaluate the significance of any advocacy and self-review threats and, if they are 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:

- Using professionals who are not members of the audit team to perform the service; or
- Having an additional partner or senior employee, not involved in providing the legal services, advise the audit team on the service and review any financial statement treatment.

290.205 The appointment of a partner or an employee of the firm as General Counsel for legal affairs of an audit client would create self-review and advocacy threats that are so significant that 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 should accept such an appointment for an audit client.

### **Recruiting Senior Management**

290.206 Recruiting senior management for an audit client, such as those in a position to exert significant influence over the preparation of the financial statements, may create self-interest, familiarity or intimidation threats. The significance of the threat will depend on factors such as:

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

The significance of the threat created 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. In all cases, the firm should not undertake management functions, including acting as negotiator or mediator on the client's behalf, and the hiring decision should be left to the client.

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 may interview candidates and advise on a candidate's competence for financial accounting, administrative or control positions.

#### *Audit Clients that are Entities of Significant Public Interest*

290.207 A firm should not provide the following recruiting services for an audit client that is an entity of significant public interest with respect to a director or officer of the client or senior management in a position to exert significant influence over the preparation of the accounting records or the financial statements on which the firm will express an opinion:

- Searching for or seeking out candidates for such positions; and
- Undertaking references checks of prospective candidates for such positions.

#### **Corporate Finance Services**

290.208 Providing corporate finance services such as (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 may create advocacy and self-review threats. 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:

- Using professionals who are not members of the audit team to provide the services; or
- Having an additional partner or senior employee, who is not involved in the provision of corporate finance services to the client, advise the audit team and review the accounting treatment and any financial statement presentation.

290.209 Providing a corporate finance service, for example advice on the structuring of a corporate finance transaction or on financing arrangements that will directly affect amounts that will be reported in the financial statements on which the firm will provide an opinion may create a self-review threat. The significance of any threat will depend on factors such as:

- The degree of subjectivity involved in determining the appropriate treatment for the outcome or consequences of the corporate finance advice in the financial statements;
- The extent to which the outcome of the corporate finance advice will directly affect amounts recorded in the financial statements and the extent to which the amounts are material to the financial statements; and

- Whether the effectiveness of the corporate finance advice depends on a particular accounting treatment or presentation in the financial statements and there is doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework.

290.210 The significance of any 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:

- Using professionals who are not members of the audit team to perform the service; or
- Having an additional partner or senior employee, who is not involved in the provision of corporate finance services to the client, advise the audit team on the service, and review the financial statement treatment.

290.211 Where the effectiveness of corporate finance advice depends on a particular accounting treatment or presentation in the financial statements and:

- (a) There is 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;

the self-review threat would be so significant that no safeguards could reduce the threat to an acceptable level, in which case the corporate finance advice service should not be provided. The only other course of action would be to withdraw from the audit engagement.

290.212 Providing corporate finance services involving promoting, dealing in, or underwriting an audit client's shares would create an advocacy or self-review threat that is so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm should not provide such services to an audit client.

## **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 or client group and concern about losing the client may create a self-interest threat. The significance of the threat will depend on factors such as:

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

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 dependency on the 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 who was not a member of the audit team review the work or otherwise advise as necessary.

### **Fees – Overdue**

290.215 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**

290.216 **Contingent fees**\* are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work. For the purposes of this section, fees are not regarded as being contingent if a court or other public authority has established them.

290.217 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.

290.218 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. If the amount of the fee for a non-assurance engagement was contingent on the result of the audit engagement, no safeguards could reduce the threats to an acceptable level. Accordingly, such arrangements should not be accepted.

290.219 For other types of contingent fee arrangements for a non-assurance service, the significance of the threats will depend on factors such as:

- The range of possible fee amounts;

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\* See Definitions.

- The degree of variability;
- The basis for determining the fee;
- Whether an independent third party will review the outcome or result of the transaction; 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:

- Review or determination of the final fee by an unrelated third party; or
- Quality control policies and procedures for the non-assurance service.

### **Compensation and Evaluation Policies**

290.220 The basis on which a partner is evaluated and compensated may create a self-interest threat to independence particularly when the partner is evaluated on or compensated for selling non-assurance services to his or her audit clients. Accordingly, a key audit partner should not be evaluated on or compensated based on that partner's success in selling non-assurance services to the audit client. This is not intended to prohibit normal profit-sharing arrangements between partners of a firm.

290.221 Compensating or evaluating other members of the audit team for selling non-assurance services to an audit client may create a self-interest threat. The significance of the threat will depend on the proportion of the individual's compensation or performance evaluation that is based on the sale of such services. The significance of the threat should be evaluated and, if the threat is not clearly insignificant the firm should either revise the compensation or evaluation plan for that individual or apply other safeguards to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Having an additional professional accountant who was not a member of the audit team review the work; or
- Removing such members from the audit team.

### **Gifts and Hospitality**

290.222 Accepting gifts or hospitality from an audit client may create self-interest and familiarity threats. When a firm or a member of the audit team accepts gifts or hospitality, unless the value is clearly insignificant, no safeguards could reduce such threats to an acceptable level. Consequently, a firm or a member of the audit team should not accept such gifts or hospitality.

### **Actual or Threatened Litigation**

290.223 When litigation takes place, or appears likely, between the firm or a member of the audit team and the audit client, a self-interest or intimidation threat may be created. The relationship between client management and the members of the audit 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 on such factors as:

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

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

- (a) If the litigation involves a member of the audit team, removing that individual from the audit team; or
- (b) Having an additional professional accountant in the firm who was not a member of the audit team review the work or otherwise advise as necessary.

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

**Paragraphs 290.224 to 290.499 are left intentionally blank for future use.**

## Restricted Use Reports

### Introduction

- 290.500 For the purpose of this section, a restricted use audit report is a report that is expressly restricted for use by only the intended users specified in the report (as discussed in the International Framework for Assurance Engagements issued by the International Auditing and Assurance Standards Board). In the case of an engagement to issue such a report, certain modifications to the requirements of Section 290 are permitted as long as the intended users of the report (1) are knowledgeable as to the purpose, subject matter information and limitations of the report, and (2) explicitly agree the application of the modified independence requirements. Knowledge as to the purpose, subject matter information and limitations of the report may be obtained by the intended users through their participation either directly, or indirectly through their representative who has the authority to act for the intended users, in establishing the nature and scope of the firm's instructions to deliver the services. Such participation enhances the ability of the firm to communicate with intended users about independence matters, including the circumstances that are relevant to the evaluation of the threats to independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level, to enable agreement with the modified independence requirements that are to be applied.
- 290.501 The firm should communicate (for example, in an engagement letter) with the intended users regarding the independence requirements that are to be applied with respect to the provision of the assurance engagement. Where the intended users are a class of users (for example, lenders in a syndicated loan arrangement) who are not specifically identifiable by name at the time the engagement terms are established, such users should subsequently be made aware of the independence requirements agreed to by the representative (for example, by the representative making the firm's engagement letter available to all users).
- 290.502 Modifications to the requirements of Section 290 should not, however, be made for the following audit engagements:
- (a) An audit of a complete set of general purpose financial statements;
  - (b) An audit of historical financial information required by law or regulation; or
  - (c) An audit of a complete set of financial statements prepared in accordance with a financial reporting framework designed for a general purpose, but not designed to achieve fair presentation (for example, relating to an insurance company regulatory filing requirement that may be available for general use).
- 290.503 For the avoidance of doubt, if the firm also performs an audit engagement for the same client for which modifications are not permitted, the provisions of paragraphs 290.500 to 290.514 do not change the independence requirements to apply the provisions of paragraphs 290.1 to 290.223 to that audit engagement.
- 290.504 The modifications to the requirements of Section 290 that may be permitted in the circumstances set out above are described in paragraphs 290.505 to 290.514. Compliance in all other respects with the provisions of Section 290 is required.

### **Entities of Significant Public Interest**

290.505 In the case of an audit engagement when the conditions set out in paragraphs 290.500 to 290.501 are met, it is not necessary to apply the additional requirements in paragraphs 290.100 to 290.223 that apply to audit engagements for entities of significant public interest.

### **Related Entities**

290.506 In the case of an audit engagement when the conditions set out in paragraphs 290.500 to 290.501 are met references to audit client do not include its related entities. However, when the audit team knows or has reason to believe that a related entity of the client is relevant to the evaluation of the firm's independence of the client, the audit team should consider that related entity when evaluating threats to independence and applying appropriate safeguards.

### **Networks and Network Firms**

290.507 In the case of an audit engagement when the conditions set out in paragraphs 290.500 to 290.501 are met reference to the firm does not include network firms. However, where the firm knows or has reason to believe that threats may be created by any interests and relationships of a network firm, they should be considered in the evaluation of threats to independence.

### **Financial Interests, Loans and Guarantees, Close Business Relationships and Family and Personal Relationships**

290.508 In the case of an audit engagement when the conditions set out in paragraphs 290.500 to 290.501 are met, the relevant provisions set out in paragraphs 290.101 to 290.141 apply to all members of the engagement team, their immediate family members and close family members.

290.509 In addition, consideration should be given to whether threats to independence are created by interests and relationships, as described in paragraphs 290.101 to 290.141, between the audit client and the following members of the audit team:

- (a) Those who provide consultation regarding technical or industry specific issues, transactions or events; and
- (b) Those who provide quality control for the engagement, including those who perform the **engagement quality control review**\*.

Consideration should also be given to any threats that the engagement team has reason to believe may be created by interests and relationships between the audit client and others within the firm who can directly influence the outcome of the audit engagement including those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the audit engagement partner in connection with the performance of the audit engagement (including those at all successively senior levels

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\* See Definitions.

above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent).

- 290.510 Consideration should also be given to any threats that the engagement team has reason to believe may be created by financial interests in the audit client held by individuals, as described in paragraphs 290.107 to 290.110 and paragraphs 290.112 to 290.113.
- 290.511 Where a threat to independence that is not clearly insignificant is identified, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level.
- 290.512 In applying the provisions set out in paragraphs 290.105 and 290.112 to interests of the firm, if the firm had a material financial interest, whether direct or indirect, in the audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, the firm should not have such a financial interest.

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

- 290.513 Consideration should also be given to threats from any employment relationships as described in paragraphs 290.131 to 290.134. Where a threat exists that is not clearly insignificant, safeguards should be applied when necessary to eliminate the threat or reduce it to an acceptable level. Appropriate safeguards might include those set out in paragraph 290.132.

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

- 290.514 If the firm provides a non-assurance service to an audit client the provisions of paragraphs 290.151 to 290.212 should be complied with, subject to paragraphs 290.505 and 290.507.

## SECTION 291

### Independence – Other Assurance Engagements

#### Objectives and Structure of this Section

- 291.1 This section addresses independence requirements for assurance engagements that are not audit or review engagements. However in limited circumstances involving certain assurance engagements where the assurance report is restricted for use by only the intended users specified in the report, the independence requirements may be modified as provided by 291.19 to 290.25 Independence requirements for audit and review engagements are addressed in Section 290. If the **assurance client**\* is also an audit or review client, the requirements in Section 290 also apply to the firm, network firms and to the members of the audit or review team.
- 291.2 Assurance engagements are designed to enhance intended users' degree of confidence about the outcome of the evaluation or measurement of a subject matter against criteria. The International Framework for Assurance Engagements (the Assurance Framework) issued by the International Auditing and Assurance Standards Board describes the elements and objectives of an assurance engagement, and identifies engagements to International Standards on Assurance Engagements (ISAEs) that apply. For a description of the elements and objectives of an assurance engagement reference should be made to the Assurance Framework.
- 291.3 Compliance with the fundamental principle of objectivity is enhanced by being independent of assurance clients. In the case of assurance engagements, it is in the public interest and, therefore, required by this Code of Ethics, that members of **assurance teams**\* and firms be independent of assurance clients and consideration be given to any threats that the firm has reason to believe may be created by network firm interests and relationships. In addition when the assurance team has reason to believe that a related entity of the assurance client is relevant to the evaluation of the firm's independence of the client, the assurance team should consider the related entity when evaluating independence and applying appropriate safeguards.
- 291.4 The objective of this section is to assist firms and members of assurance teams in applying a conceptual approach to achieving and maintaining independence that involves:
- (a) Identifying threats to independence;
  - (b) Evaluating whether these threats are clearly insignificant; and
  - (c) When the threats are not clearly insignificant, identifying and applying appropriate safeguards to eliminate the threats or reduce them to an acceptable level.

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\* See Definitions.

Professional judgment should be used to determine the appropriate safeguards to eliminate any threats or reduce them to an acceptable level. If appropriate safeguards are not available, the assurance engagement should be declined or terminated.

- 291.5 This section does not 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. Accordingly, firms should have policies and procedures, appropriately documented and communicated, to assign responsibility for (a) identifying and evaluating threats to independence and (b) applying appropriate safeguards to eliminate any threats or reduce them to an acceptable level.
- 291.6 This section concludes with some examples (paragraphs 291.100 onwards) of how the conceptual approach to independence is to be applied to specific circumstances and relationships. The examples are not intended to be all-inclusive.

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

- 291.7 Independence requires:

#### *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 assurance team's, integrity, objectivity or professional skepticism has been compromised.

- 291.8 Many different circumstances, or combination of circumstances, may be relevant in assessing independence. Accordingly, it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action. 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 that may be arbitrary, is, therefore, in the public interest.
- 291.9 In deciding whether to accept or continue an engagement, or whether a particular individual should be a member of the assurance team, a firm should, therefore, evaluate the relevant circumstances and consider the availability of appropriate safeguards to eliminate the threat or reduce it to an acceptable level. Assurance engagements encompass a broad range of engagements and can take many forms. The evaluation should be supported by information obtained before accepting the engagement and information that comes to the attention of the assurance team during the engagement.

### **Assurance Engagements**

- 291.10 As further explained in the Assurance Framework, 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.

- 291.11 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 a subject matter. For example, the Framework states that an assertion about the effectiveness of internal control (subject matter information) results from applying a framework for evaluating the effectiveness of internal control, such as COSO<sup>1</sup> or CoCo<sup>2</sup>, (criteria) to internal control, a process (subject matter).
- 291.12 Assurance engagements may be assertion-based or direct reporting. In either case they involve three separate parties: a professional accountant in public practice, a responsible party and intended users.
- 291.13 In an assertion-based assurance 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 the responsible party that is made available to the intended users.
- 291.14 In a direct reporting assurance 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 subject matter information is provided to the intended users in the assurance report.

### **Assertion-based Assurance Engagements**

- 291.15 In an assertion-based assurance engagement, the members of the assurance team and the firm are required to be independent of the assurance client (the responsible party, which is responsible for the subject matter information and may be responsible for the subject matter). Such independence requirements prohibit certain relationships between members of the assurance team and (a) directors, (b) officers and (c) employees of the client in a position to exert 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 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<sup>3</sup> interests and relationships.
- 291.16 In the majority of assertion-based assurance engagements the responsible party is responsible for both the subject matter information and the subject matter. However, in some engagements the responsible party may not be responsible for the subject matter. For example, when a professional accountant in public practice is engaged to perform an assurance engagement regarding a report that an environmental consultant has prepared about a company’s sustainability practices, for distribution to intended users, the

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<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.

<sup>3</sup> See paragraphs 290.10 to 290.21 for guidance on what constitutes a network firm.

environmental consultant is the responsible party for the subject matter information but the company is responsible for the subject matter (the sustainability practices).

291.17 In assertion-based assurance engagements where the responsible party is responsible for the subject matter information but not the subject matter, the members of the assurance team and the firm are required to be independent of the party responsible for the subject matter information (the assurance client). In addition, 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.

### **Direct Reporting Assurance Engagements**

291.18 In a direct reporting assurance engagement 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). Consideration should also be given to any threats the firm has reason to believe may be created by network firm interests and relationships.

### **Restricted Use Reports**

291.19 For the purpose of this section, a restricted use assurance report is a report that is expressly restricted for use by only the intended users specified in the report (as discussed in the International Framework for Assurance Engagements issued by the International Auditing and Assurance Standards Board). In the case of an assurance engagement, other than an audit or review engagements, to issue such a report, certain modifications to the requirements of Section 291 are permitted as long as the intended users of the report (1) are knowledgeable as to the purpose, subject matter information and limitations of the report, and (2) explicitly agree to the application of the modified independence requirements. Knowledge as to the purpose, subject matter information and limitations of the report may be obtained by the intended users through their participation, either directly or indirectly through their representative who has the authority to act for the intended users, in establishing the nature and scope of the firm's instructions to deliver the services. Such participation enhances the ability of the firm to communicate with intended users about independence matters, including the circumstances that are relevant to the evaluation of the threats to independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level, to enable agreement with the modified independence requirements that are to be applied.

291.20 The firm should communicate (for example, in an engagement letter) with the intended users regarding the independence requirements that are to be applied with respect to the provision of the assurance engagement. Where the intended users are a class of users (for example, lenders in a syndicated loan arrangement) who are not specifically identifiable by name at the time the engagement terms are established, such users should subsequently be made aware of the independence requirements agreed to by the representative (for example, by the representative making the firm's engagement letter available to all users).

291.21 For the avoidance of doubt, if the firm also performs an assurance engagement for the same client for which modifications are not permitted, the provisions of paragraphs 291.23 to

291.25 do not change the requirement to apply the provisions of paragraphs 291.1 to 291.156 to that assurance engagement.

291.22 The modifications to the requirements of Section 291 that are permitted in the circumstances set out above are described in paragraphs 291.23 to 290.25. Compliance in all other respects with the provisions of Section 291 is required.

291.23 In the case of an assurance engagement when the conditions set out in paragraphs 290.19 to 290.20 are met, the relevant provisions set out in paragraphs 291.103 to 291.132 apply to all members of the engagement team, their immediate and close family members. In addition, consideration should be given to whether threats to independence are created by interests and relationships between the assurance client and the following other members of the assurance team:

- Those who provide consultation regarding technical or industry specific issues, transactions or events; and
- Those who provide quality control for the engagement, including those who perform the engagement quality control review.

Consideration should also be given, by reference to the provisions set out in paragraphs 291.103 to 291.132, to any threats that the engagement team has reason to believe may be created by interests and relationships between the assurance client and others within the firm who can directly influence the outcome of the assurance engagement including 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.

291.24 In the case of an assurance engagement when the conditions set out in paragraphs 290.19 to 290.20 are met 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. Accordingly, the firm should not have such a financial interest. In addition, the firm is required to comply with the other applicable provisions of this section described in paragraphs 291.112 to 291.156.

291.25 Consideration should also be given to any threats that the firm has reason to believe may be created by network firm interests and relationships.

### **Multiple Responsible Parties**

291.26 In some assurance engagements, whether assertion-based or direct reporting there might be several responsible parties. In determining whether it is necessary to apply the provisions in this section to each responsible party in such engagements, the firm may take into account whether an interest or relationship between the firm, or a member of the assurance team, and a particular responsible party would create a threat to independence that is not clearly insignificant in the context of the subject matter information. This will take into account factors such as:

- The materiality of the subject matter information (or of the subject matter) for which the particular responsible party is responsible; and
- The degree of public interest associated with the engagement.

If the firm determines that the threat to independence created by any such interest or relationship with a particular responsible party would be clearly insignificant, it may not be necessary to apply all of the provisions of this section to that responsible party.

### **Documentation**

291.27 Standards on quality control and assurance standards require documentation of matters important to the assurance engagement. Although documentation is not, in itself, a determinant of whether a firm is independent, 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 describe the threats identified and the safeguards applied to eliminate them or reduce them to an acceptable level.

### **Engagement Period**

291.28 Independence from the assurance client is required both during the engagement period and the period covered by the subject matter information. The engagement period starts when the assurance team begins to perform assurance services with respect to the particular engagement. The engagement period ends when the assurance report is issued, except when the engagement is of a recurring nature. In such a case it ends at the later of the notification by either party that the professional relationship has terminated or the issuance of the final assurance report.

291.29 When an entity becomes an assurance client during or after the period covered by the subject matter information on which the firm will express a conclusion, the firm should consider whether any threats to independence may be created by:

- Financial or business relationships with the assurance client during or after the period covered by the subject matter information, but before accepting the assurance engagement; or
- Previous services provided to the assurance client.

291.30 If a non-assurance service was provided to the assurance client during or after the period covered by the subject matter information but before the commencement of professional services in connection with the assurance engagement and the service would be prohibited during the period of the assurance engagement, consideration should be given to any threats to independence arising from the service. If the threat is not clearly insignificant, safeguards should be considered and applied when necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Obtaining the client's acknowledgement of responsibility for the results of the non-assurance service;

- Precluding personnel who provided the non-assurance service from being members of the assurance team; or
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

### **Other Considerations**

291.31 There may be occasions when there is an inadvertent violation of this section. If such an inadvertent violation occurs, it would generally not compromise independence with respect to the 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.

291.32 Throughout this section, reference is made to significant and clearly insignificant threats to 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.

**SECTION 291 OF THE CODE OF ETHICS**  
**INDEPENDENCE – OTHER ASSURANCE ENGAGEMENTS**

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## **Introduction**

- 291.100 The following examples describe specific circumstances and relationships that may create threats to independence. The examples describe the potential threats 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 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 200.12 to 200.15 can be applied to satisfactorily address the threats to independence.
- 291.101 The examples illustrate how the framework applies to assurance engagements. The examples should be read in conjunction with paragraph 291.26 which explains that, in the majority of assurance engagements, there is one responsible party and that responsible party is the assurance client. However, in some assurance engagements there are two or more 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. For assurance reports expressly restricted for use by identified users the examples should be read in the context of paragraphs 291.19 to 291.25.
- 291.102 Interpretation 2005-01 provides further guidance on applying the independence requirements contained in this section to assurance engagements.

## **Financial Interests**

- 291.103 Holding a financial interest in an assurance client may create a self-interest threat. In evaluating the significance of any threat, and the appropriate safeguards to be applied to eliminate it or reduce it to an acceptable level, it is necessary to evaluate the nature of the financial interest. This includes evaluating (a) the role of the person holding the financial interest, (b) the materiality of the financial interest and (c) whether the financial interest is direct or indirect.
- 291.104 When evaluating whether the financial interest is direct or indirect, 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 it holds (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 direct owner or trustee) or is able to influence investment decisions. In evaluating the significance of any threat to independence from an interest held through an investment vehicle, it is important to consider the nature of the financial interest and whether control can be exercised over the intermediary or its investment strategy. When control or the ability to influence investment decisions exists, the financial interest should be considered direct. Conversely, when the holder of the financial interest has no ability to exercise control or influence the investment decisions the financial interest should be considered indirect.

- 291.105 If a member of the assurance team, an immediate family member, or a firm has a direct financial interest or a material indirect financial interest in the assurance client, the self-interest threat would be so significant no safeguards could eliminate the threat or reduce it to an acceptable level. Therefore, none of the following should have a direct financial interest or a material indirect financial interest in the client: a member of the assurance team; his or her immediate family member; or the firm.
- 291.106 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 to the close family member. 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:
- The close family member disposing, as soon as practicable, of all of the financial interest or disposing of a sufficient portion of an indirect financial interest so that the remaining interest is no longer material;
  - Having a professional accountant perform an additional review of the work of the relevant member of the assurance team; or
  - Removing the individual from the assurance team.
- 291.107 If a member of the assurance team, his or her immediate family member, or a firm has a financial interest in an entity that has a controlling interest in the assurance client, and the client is material to the entity, the self-interest threat would be so significant that no safeguards could reduce the threat to an acceptable level. Therefore, none of the following should have such a financial interest: a member of the assurance team; his or her immediate family member; or the firm.
- 291.108 The holding by a firm or a member of the assurance team, or his or immediate family member, of a direct financial interest or a material indirect financial interest in the assurance client as a trustee, may create a self-interest threat. Accordingly, such an interest should only be held when:
- Neither the member of the assurance team, nor the immediate family, nor the firm are 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, the immediate family member, or the firm does not have significant influence over any investment decision involving a financial interest in the assurance client.

291.109 Consideration should be given by the assurance team as to whether a self-interest threat may be created by any known financial interests in the assurance client held by other individuals including:

- Partners, and professional employees of the firm, other than those referred to above, or their immediate family members; and
- Individuals with a close personal relationship with a member of the assurance team.

Whether these interests create a self-interest threat will depend on 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 any 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:

- Removing the member of the assurance team with the personal relationship from the assurance team;
- Excluding the member of the assurance team from any significant decision-making concerning the assurance engagement; or
- Having a professional accountant perform an addition review of the work of relevant member of the assurance team.

291.110 If a firm, a member of the assurance team, or his or her immediate family member, receives a direct financial interest or a material indirect financial interest in an assurance client, for example, by way of an inheritance, gift or, as a result of a merger, and such interest would not be permitted to be held under this section then:

- (a) If the interest is received by the firm, the financial interest should be disposed of immediately, or a sufficient amount of an indirect financial interest should be disposed of so that the remaining interest is no longer material or the firm should withdraw from the assurance engagement.
- (b) If the interest is received by a member of the assurance team, or his or her immediate family member, the individual should immediately dispose of the financial interest, or dispose of a sufficient amount of an indirect financial interest so that the remaining interest is no longer material, or the individual should be removed from the team.

291.111 An inadvertent violation of this section as it relates to a financial interest in an assurance client would not compromise independence as long as:

- (a) The firm has established policies and procedures that require all professionals to promptly report to the firm any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;
- (b) In the case of a purchase by an individual, the individual is advised that the financial interest should be disposed and the disposal takes place as soon as possible after the

identification of the issue or in other circumstances the actions prescribed in paragraph 291.110 are taken;

- (c) In the case of a purchase by the firm, the disposal takes place immediately after the identification of the issue and;
- (d) The firm considers whether any other safeguards should be applied. Such safeguards might include:
  - Involving an additional professional accountant to review the work of the member of the assurance team; or
  - Excluding the individual from any significant decision-making concerning the assurance engagement.

In addition, consideration should be given to discussing the matter with those charged with governance.

### **Loans and Guarantees**

291.112 A loan, or a guarantee of a loan, to the firm or a member of the assurance team from an assurance client that is a bank or a similar institution, may create a threat to independence. If the loan or guarantee is not made under normal lending procedures, terms and requirements the self-interest threat would be so significant no safeguards could reduce the threat to an acceptable level. Accordingly, neither a firm nor a member of the assurance team should accept such a loan or guarantee.

291.113 If a loan to a firm is made under normal lending procedures, terms and requirements and it is material to the assurance client or firm it may be possible to apply safeguards to reduce the self-interest threat to an acceptable level. Such safeguards might include a review of the work by an additional professional accountant from a network firm that is not involved with the assurance engagement and did not receive the loan.

291.114 A loan, or a guarantee of a loan, from an assurance client that is a bank or a similar institution to a member of the assurance team or his or her immediate family member would not create a threat to independence if 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.

291.115 If the firm, or a member of the assurance team, or his or her immediate family member, makes or guarantees a loan to an assurance client that is not a bank or similar institution the self-interest threat would be so significant that no safeguards 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, or his or her immediate family member, and the assurance client. However, deposits made by, or brokerage accounts of, a firm or member of the assurance team, or his or her immediate family member, with an assurance client that is a bank, broker or similar institution would not create a threat to independence if the deposit or account is held under normal commercial terms.

291.116 Similarly, if the firm or a member of the assurance team, or his or her immediate family member, accepts a loan or loan guarantee from an assurance client that is not a bank or similar institution, the self-interest threat would be so significant that no safeguards 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, or the immediate family member, and the client.

### **Close Business Relationships**

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

- Having a financial interest in a joint venture with either the 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 client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm distributes or markets the client's products or services, or the client distributes or markets the firm's products or services.

Unless any financial interest is immaterial and the relationship is clearly insignificant to the firm and the client or its management, no safeguards could reduce the threat to an acceptable level. If the magnitude of the relationship cannot be reduced so that the financial interest is immaterial and the relationship is clearly insignificant:

- (a) The business relationship should be terminated; or
- (b) The firm should refuse to perform the assurance engagement.

In the case of a member of the assurance team, unless any such financial interest is immaterial and the relationship is clearly insignificant to that member, the individual should be removed from the assurance team.

If the close business relationship is between an immediate family member of a member of the assurance team and the assurance client or its management, 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.

291.118 The purchase of goods and services from an assurance client by the firm, or a member of the assurance team, or his or her immediate family member, would not generally create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions may be of such a nature or magnitude that they to create a self-interest threat. 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:

- Eliminating or reducing the magnitude of the transaction; or
- Removing the individual from the assurance team.

### **Family and Personal Relationships**

291.119 Family and personal relationships between a member of the assurance team and a director, officer or certain employees (depending on their role) of the assurance client, may create self-interest, familiarity or intimidation threats. Their significance will depend on a number of factors, including the individual's responsibilities in the assurance team, the closeness of the relationship and the role of the family member or other individual within the client. Consequently, the particular circumstances will need to be evaluated in assessing the significance of these threats.

291.120 When an immediate family member of a member of the assurance team is:

- (a) A director or an officer of the assurance client, or
- (b) An employee in a position to exert significant influence over the subject matter information of the assurance engagement,

or was in such a position during any period covered by the engagement or the subject matter information, 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 this safeguard is not applied the firm should withdraw from the assurance engagement.

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

- The position held by the immediate family member; and
- The role of the professional on the assurance team.

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:

- Removing the individual from the assurance team; or
- 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.

291.122 Threats to independence may be created when a close family member of a member of the assurance team is:

- (a) A director or an officer of the assurance client; or

(b) An employee in a position to exert significant influence over the subject matter information of the assurance engagement. The significance of the threats will depend on factors such as:

- The nature of the relationship between the member of the assurance team and his or her close family member;
- The position held by the close family member; and
- The role of the professional on the assurance team.

The significance of any 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:

- Removing the individual from the assurance team; or
- 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.

291.123 Threats to independence 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) a close relationship with the member of the assurance team and (b) is a director or an officer or an employee in a position to exert significant influence over the subject matter information of the assurance engagement. The significance of the threats will depend on factors such as:

- The nature of the relationship between the individual and the member of the assurance team;
- The position the individual holds with the client; and
- The role of the professional on the assurance team.

Members of the assurance team are responsible for identifying any such persons and for consulting in accordance with firm policies and procedures. The significance of any 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:

- Removing the professional from the assurance team; or
- Structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the individual with whom he or she has a close relationship.

291.124 Consideration should be given to whether self-interest, familiarity or intimidation threats may be created by a personal or family relationship between (a) a partner or employee of the firm who is not a member of the assurance team and (b) a director or an officer of the assurance client or an employee in a position to exert significant influence over the subject matter information of the assurance engagement. The significance of any threat will depend on factors such as:

- The nature of the relationship between the partner or employee of the firm and the director, officer or employee of the client;
- The interaction of the partner or employee of the firm with the assurance team;
- The position of the partner or employee within the firm; and
- The role of the individual within the client.

Partners and employees of the firm are responsible for identifying any such relationships and for consulting in accordance with firm policies and procedures. The significance of any 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:

- Structuring the partner's or employee's responsibilities to reduce any potential influence over the assurance engagement; or
- Having another professional accountant review the relevant assurance work or otherwise advise as necessary.

291.125 An inadvertent violation of this section as it relates to family and personal relationships would not compromise independence if:

- (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) The inadvertent violation relates to an immediate family member of a member of the assurance team becoming a director or an officer of the assurance client or an employee in a position to exert significant influence over the subject matter information of the assurance engagement, the relevant professional is removed from the assurance team; and
- (c) The firm considers and applies as appropriate other safeguards. Such safeguards might include:
  - Having an additional professional accountant review the work of the member of the assurance team; or
  - Excluding the relevant professional from any significant decision-making concerning the engagement.

### **Employment with Assurance Clients**

291.126 Self-interest, familiarity or intimidation threats may be created if a director or an officer of the assurance client or an employee who is in a position to exert significant influence over the subject matter information of the assurance engagement has been a member of the assurance team or partner of the firm. This would be particularly the case when significant connections remain between the individual and his or her former firm.

291.127 If a member of the assurance team, partner or former partner of the firm has joined the assurance client in such a position, the significance of the self-interest, familiarity or intimidation threats will depend on factors such as:

- (a) The position the individual has taken at the client;
- (b) Any involvement the individual will have with the assurance team;
- (c) The length of time since the individual was a member of the assurance team or firm;  
and
- (d) The former position of the individual within the assurance team or firm, for example, whether the individual was responsible for maintaining contact with management and those charged with governance.

In all cases the following safeguard is necessary to ensure that no significant connection remains between the firm and the individual does not continue to participate in the firm's business or professional activities:

The significance of any remaining threat should be evaluated and if it 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:

- Making arrangements such that the individual is not entitled to any benefits or payments from the firm, unless made in accordance with fixed pre-determined arrangements.
- Making arrangements such that any amount owed to the individual should not be material to the firm;
- Modifying the plan for the assurance engagement;
- Assigning an assurance team that is of sufficient experience in relation to the individual who has joined the client; or
- Having an additional professional accountant review the work or otherwise advise as necessary.

291.128 If a former partner of the firm has previously joined an entity in such a position and the entity subsequently becomes an assurance client of the firm, any threats to independence should be evaluated and if the threats not than clearly insignificant, safeguards should be considered and applied, when necessary, to eliminate the threat or reduce it to an acceptable level.

291.129 A self-interest threat is created when a member of the assurance team participates in the assurance engagement while knowing that he or she will, or may, join the client some time in the future. Firm policies and procedures should require members of an assurance team to notify the firm when entering employment negotiations with the client. On such notification, 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:

- (a) Removal of the individual from the assurance team; or
- (b) A review of any significant judgments made by that individual while on the team.

### **Recent Service with an Assurance Client**

291.130 Self-interest, familiarity or intimidation threats may be created if a former director, officer or employee of the assurance client serves as a member of the assurance team. This would be particularly true when, for example, a member of the assurance team has to evaluate elements of the subject matter information he or she had prepared while with the assurance client.

291.131 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 as an employee in a position to exert 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.

291.132 Self-interest, self-review or familiarity threats may be created if, before 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 as an employee in a position to exert significant influence over the subject matter information of the assurance engagement. 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 on factors such as:

- The position the individual held with the assurance client;
- The length of time since the individual left the assurance client; and
- The role of the professional on the assurance team.

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 reduce the threat to an acceptable level. Such safeguards might include conducting an additional review of the work performed by the individual as part of the assurance team.

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

291.133 If a partner or employee of the firm serves at the same time as a director or an officer of an assurance client, the self-review and self-interest threats would be so significant that no safeguards could reduce the threats to an acceptable level. Therefore, if such an individual were to accept such a position the firm should decline or withdraw from the assurance engagement.

291.134 The position of Company Secretary has different implications in different jurisdictions. 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.

- 291.135 If a partner or employee of the firm serves as Company Secretary for an assurance client, the self-review and advocacy threats would generally be so significant, that no safeguards could reduce the threat to an acceptable level. When this practice is specifically permitted under local law, professional rules or practice, the duties and functions should be limited to those of a routine and administrative nature preparing minutes and maintaining statutory returns. Further, management should make all relevant decisions. The significance of any threat should be evaluated and, if not clearly insignificant, safeguards should be applied to eliminate the threat or reduce it to an acceptable level.
- 291.136 Performing, routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters will not generally compromise independence, as long as client management makes all relevant decisions.

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

291.137 Familiarity, self-review or self-interest threats may be created by using the same senior personnel on an assurance engagement over a long period of time. The significance of the threat will depend on factors such as:

- How long the individual has been a member of the assurance team;
- The role of the individual on the assurance team;
- The structure of the firm;
- The nature of the assurance engagement;
- Whether the client's management team has changed; and
- Whether the nature or complexity of the subject matter information has changed.

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:

- Rotating the senior personnel off the assurance team;
- Having an additional professional accountant who was not a member of the assurance team review the work of the senior personnel; or
- Regular independent internal or external quality reviews of the engagement.

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

291.138 Firms have traditionally provided to their assurance clients a range of non-assurance services that are consistent with their skills and expertise. Provision of non-assurance services may, however, create threats to the independence of the firm or the members of the assurance team. New developments in business, the evolution of financial markets and

changes in information technology make it impossible to draw up an all-inclusive list non-assurance services that might be provided to an assurance client.

- 291.139 Before the firm accepts an engagement to provide a non-assurance service to an assurance client, consideration should be given to whether providing such a service would create a threat to independence. In evaluating the significance of any threat created by a particular non-assurance service, consideration should be given to any threat that the team has reason to believe may be created by providing other related non-assurance services. In some cases it may be possible to eliminate or reduce the threat created by application of safeguards. In other cases no safeguards could reduce the threat to an acceptable level. Accordingly the non-assurance service should not be provided.

### **Management Responsibilities**

- 291.140 Management of an entity performs many functions in managing the entity in the best interests of stakeholders. It is not possible to specify every function that is a management responsibility. However, management functions involve leading and directing an entity including making significant decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources.
- 291.141 Whether an activity is a management function depends on the circumstances and requires the exercise of judgment. Examples of activities that would generally be considered management functions include:
- Setting policies and strategic direction;
  - Authorizing transactions;
  - Deciding which recommendations of the firm or other third parties should be implemented; and
  - Taking responsibility for designing, implementing and maintaining internal control.
- 291.142 Performing management functions for an assurance client that is not an audit or review client may create threats to independence. If a firm performs management functions as part of the assurance service the threats created could not be reduced to an acceptable level by any safeguard. Accordingly, in providing assurance services to an assurance client that is not an audit or review client, a firm should not perform management functions as part of the assurance service. If the firm performs a management function as part of any other services provided to the assurance client, it should ensure that the function is not related to the subject matter and subject matter information of an assurance engagement provided by the firm.
- 291.143 Some activities would not be considered management functions because they are routine and administrative, involve matters that are insignificant or do not otherwise represent a management responsibility. For example, executing an insignificant transaction that has been authorized by management or monitoring the dates for filing statutory returns and advising an assurance client of those dates would not be considered management functions. Further, providing advice and recommendations to assist management in performing their

functions or providing elements of a client's internal training program would not be considered a management function.

291.144 To avoid the risk of performing management functions related to the subject matter or subject matter information of the assurance engagement, the firm should be satisfied that a member of management with a sufficient level of understanding of the service, and an ability to evaluate the results, has been designated to make all significant judgments and decisions connected with the services and to accept responsibility for the actions to be taken arising from the results of the service received. This reduces the risk of inadvertent significant judgments or decisions by the firm. This risk is further reduced when the firm gives the client the opportunity to make judgments and decisions based on an objective and transparent analysis and presentation of the issues.

### **Other Matters**

291.145 Threats to independence might be created when a firm provides a non-assurance service related to the subject matter information of an assurance engagement. In such cases, consideration should be given to the significance of the firm's involvement with the subject matter information of the engagement, whether any self-review threats are created and whether any threat to independence that is not clearly insignificant can be reduced to an acceptable level by the application of safeguards.

291.146 A self-review threat may be created if the firm is involved in the preparation of subject matter information which is subsequently the subject matter information of an assurance engagement. For example, a self-review threat would be created if the firm developed and prepared prospective financial information and subsequently provided assurance on this 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 created is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level.

291.147 When a firm performs a valuation that forms part of the subject matter information of an assurance engagement the firm should consider any self-review threat. 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.

### **Fees**

#### **Fees – Relative Size**

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

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

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

291.149 A self-interest threat may also be created when the fees generated from an assurance 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 who was not a member of the assurance team review the work or otherwise advise as necessary.

### **Fees – Overdue**

291.150 A self-interest threat may be created if fees due from an assurance client remain unpaid for a long time, especially if a significant part is not paid before the issue of the assurance report, if any, for the following period. Generally the firm should require payment of such fees before any such report is issued. The following safeguard may be applicable having an additional professional accountant who did not take part in the assurance engagement provide advice or review the work. 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**

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 work. For the purposes of this section, fees are not regarded as being contingent if a court or other public authority has established 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 amount of the fee for a non-assurance engagement was contingent on the result of the assurance engagement no safeguards could reduce the threat to an acceptable level. Accordingly, such arrangements should not be accepted.

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

- The range of possible fee amounts;

- The degree of variability;
- The basis for determining the fee;
- Whether an independent third party will review the outcome or result of the transaction; 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 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:

- Review or determination of the final fee by an unrelated third party; or
- Quality control policies and procedures for the non-assurance service.

### **Gifts and Hospitality**

291.155 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, no safeguards could reduce the threats to an acceptable level. Consequently, a firm or a member of the assurance team should not accept such gifts or hospitality.

### **Actual or Threatened Litigation**

291.156 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 on such factors as:

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

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

- (a) If the litigation involves a member of the assurance team, removing that individual from the assurance team; or
- (b) Having an additional professional accountant in the firm who was not a member of the assurance team review the work or otherwise advise as necessary.

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

## Definitions

In this Code of Ethics for Professional Accountants the following expressions have the following meanings assigned to them:

Advertising	The communication to the public of information as to the services or skills provided by professional accountants in public practice with a view to procuring professional business.
Assurance client	The responsible party that is the person (or persons) who: (a) In a direct reporting engagement, is responsible for the subject matter; or (b) In an assertion-based engagement, is responsible for the subject matter information and may be responsible for the subject matter.
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.)
Assurance team	(a) All members of the engagement team for the assurance engagement; (b) All others within a firm who can directly influence the outcome of the assurance engagement, including: <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;</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, including those who perform the engagement quality control review for the assurance engagement.</li></ul>
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.

## DEFINITIONS

Audit engagement	A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether historical financial information is prepared in all material respects in accordance with an identified 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	<p>(a) All members of the engagement team for the audit engagement; and</p> <p>(b) All others within a firm who can directly influence the outcome of the audit engagement, including:</p> <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> <p>(c) All those within a network firm who can directly influence the outcome of the audit engagement.</p>
Clearly insignificant	A matter that is deemed to be both trivial and inconsequential.
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 or result of a transaction or the result of the work performed. A fee that is established by a court or other public authority is not a contingent fee.
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>
Director or officer	Those charged with the governance of an entity, regardless of their title, which may vary from country to country.

## DEFINITIONS

Engagement partner	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.
Engagement quality control review	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.
Engagement team	All partners and staff performing the engagement, and any individuals contracted by the firm who provide services on the engagement that might otherwise be provided by a partner or staff of the firm.
Existing accountant	A professional accountant in public practice currently holding an audit appointment or carrying out accounting, taxation, consulting or similar professional services for a client.
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.
Financial statements	A structured representation of historical financial information, which ordinarily includes explanatory 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 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.
Firm	(a) A sole practitioner, partnership or corporation of professional accountants; (b) An entity that controls such parties; and (c) An entity controlled by such parties.
Historical financial information	Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
Immediate family	A spouse (or equivalent) or dependent.

## DEFINITIONS

Independence	<p>Independence is:</p> <ul style="list-style-type: none"><li>(a) 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</li><li>(b) 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.</li></ul>
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.
Key audit partner	The engagement partner, the individual responsible for the engagement quality control review, and other audit partners on the engagement team, such as lead partners on significant subsidiaries or divisions, who are responsible for key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion.
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	<p>A larger structure:</p> <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>
Network firm	A firm or entity that belongs to a network.
Office	A distinct sub-group, whether organized on geographical or practice lines.
Professional accountant	An individual who is a member of an IFAC member body.
Professional accountant in business	A professional accountant employed or engaged in an executive or non-executive capacity in such areas as commerce, industry, service, the public sector, education, the not for profit sector, regulatory bodies or professional bodies, or a professional accountant contracted by such entities.

DEFINITIONS

Professional accountant in public practice	A professional accountant, irrespective of functional classification (e.g., audit, tax or consulting) in a firm that provides professional services. This term is also used to refer to a firm of professional accountants in public practice.
Professional services	Services requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services.
Related entity	<p>An entity that has any of the following relationships with the client:</p> <ul style="list-style-type: none"><li>(a) An entity that has direct or indirect control over the client if the client is material to such entity;</li><li>(b) An entity with a direct financial interest in the client if that such entity has significant influence over the client and the interest in the client is material to such entity;</li><li>(c) An entity over which the client has direct or indirect control;</li><li>(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</li><li>(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.</li></ul>
Review client	An entity in respect of which a firm conducts a review engagement.
Review engagement	An assurance engagement in which a professional accountant in public practice expresses a conclusion on whether, on the basis of the procedures which do not provide all the evidence that would be required in an audit, anything has come to the accountant’s attention that causes the accountant to believe that the historical financial information is not prepared in all material respects, in accordance with an applicable financial reporting framework, which is an engagement conducted in accordance with International Standards on Review Engagements or equivalent.

DEFINITIONS

- Review team
- (a) All members of the engagement team for the review engagement; and
  - (b) All others within a firm who can directly influence the outcome of the review engagement, including:
    - (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 review 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);
    - (ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the engagement; and
    - (iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and
  - (c) All those within a network firm who can directly influence the outcome of the review engagement.
- Those charged with governance
- 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.



**International Federation of Accountants**

545 Fifth Avenue, 14<sup>th</sup> Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 [www.ifac.org](http://www.ifac.org)