Chartered Accountants Regulatory Board

Ethical Framework and Auditor Independence

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Objective of the Course

The last few years have seen significant debate on the topic of independence and in particular the independence of auditors.

As a result we have seen recent pronouncements from the European Commission, and the International Federation of Accountants resulting in the issue of the Code of Ethics for Warrant Holders (the Code).

Each professional accountant will react differently when faced with an ethical dilemma. As each situation is different it would be impossible to develop guidance to cover all eventualities however a general framework can be applied, which should assist accountants in their deliberations.

Therefore the objective of this session (and this paper) is to put the pronouncements on independence into context in relation to the Code and to provide warrant holders with information on a number of specific provisions of the independence requirements and their impact on their firms.

Ethical Responsibilities

The distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Professional accountants and their member bodies have always recognised that the privilege of being a member of a profession brings with it ethical responsibilities. At the core of our ethical responsibilities is the absolute need to at all times act with integrity.

'An organisation must develop/demonstrate a reputation for integrity. This in its turn requires a commitment to act at all times with integrity and in the interest of all stakeholders' (Richard Branson).

In the current environment of local and global scandals and enquiries more people are questioning accountants' attitudes to ethics, it is important therefore that professional accountants and their member bodies are seen to be 'taking ethics to heart'. Thus there is an expectation that professional accountants observe high standards of conduct, which may in certain instances require them to act in a manner contrary to their own personal interest.

What is Ethics and Ethical Behaviour?

Everyone has their own understanding of what ethics means and what therefore constitutes ethical behaviour.

Taking, as a first step, the dictionary definitions and thesaurus references:

Ethics: conscience, moral code, morality, principles, rules of conduct, standards.
Ethical: conscientious, correct, decent, fair, fitting, good, honest, just, moral, principled, proper, right, upright.

A simple description of ethics taken from J. Donaldson 'Key Issues in Business Ethics' is:

Ethics is concerned with how an attitude, action or decision is determined as 'right' or 'wrong' or 'good' or 'evil'

In determining whether an issue under consideration is right or wrong a number of factors should be considered including the:

- Consequences of the action.
- Motivation for the action.
- Inherent 'rightness' of the action.

Ethical behaviour could therefore be seen as doing the 'right' thing. This is of course too simplistic.

A better description would be:
The proper consideration of any action or decision to determine:

- The nature and extent of the ethical threat posed by this action or decision; and
- The action to be taken to address any possible ethical threats.

Ethical Decision Making

Professional accountants sub consciously make ethical decisions in every aspect of the daily performance of their professional role. In most instances the thought process and the decision made is instinctive- a simple recognition of right and wrong.

These instinctive decisions arise from a desire to do the right thing reinforced by a professional and technical competence, which ensures that the professional accountant has a clear understanding of where an activity is right or wrong. In some instances this is obvious, for example money laundering, insider trading, fraud etc. However there are many other instances arising from core business or professional activities which do not involve situations which are blatantly wrong but where the accountant recognises that there may be an ethical issue which requires consideration.

In today's working environment professional accountants increasingly face pressures which may impact upon their ability to maintain high ethical standards. The real challenge for professional accountants is to:

- Set high professional, including ethical, standards and live up to them; and
- Make the 'right' decision- even if this would personally disadvantage them and/or their firm/employer- when difficult decisions need to be made.

In determining whether you have made the 'right' decision the professional accountant should always pause and ask him/herself the following important questions:

- *Is my decision morally defensible?*
- *Would a reasonable (and informed) third party reach the same conclusion?*
- *Will the decision potentially compromise my professional and/or personal reputation?*
- *If my decision was subject to public scrutiny would I, my family and my colleagues be proud?*

If there is any doubt in relation to any of the above questions then there is a threat that needs to be considered and addressed.

This is a significant challenge with which warrant holders need support and guidance from their Institute.

Ethical Decision Making and the Framework Approach

In recognition of the considerable challenges faced by professional accountants in addressing ethical issues the International Ethics Standards Board for Accountants has Code of Ethics using a Framework Approach for Ethics. This approach has been endorsed by the Accountancy Board.

The Code establishes the Fundamental Principles and provides a framework into which warrant holders can fit many ethical dilemmas; the 'Framework' provides a conceptual approach to resolving ethical dilemmas. Part B includes specific examples to illustrate the application of the principles together with examples of the types of <u>threats</u> which might be encountered and the <u>safeguards</u> which could be applied to eliminate or reduce the threats to an acceptable level. In certain instances where a significant threat has been recognised and no safeguard can reduce the threat to an acceptable level a <u>prohibition</u> has been included.

The Fundamental Principles

Fundamental Principles	
Integrity	A warrant holder should be straight forward and honest in all professional business relationships Integrity also implies fair dealing and truthfulness.
Objectivity	A warrant holder should not allow prejudice or bias, conflict or interest or undue influence of others to override professional or business judgements.
Professional Competence and Due Care	A warrant holder has a continuing duty to maintain professional knowledge and skill at a level required to ensure the client or employer receives the advantage of competent professional service based on current developments in practice, legislation and techniques. A warrant holder should act diligently and in accordance with applicable technical standards in all professional and business relationships.
Confidentiality	A warrant holder should respect the confidentiality of information acquired as a result of professional or business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the warrant holder or third parties.
Professional Behavior	A warrant holder should comply with relevant laws and regulations and should avoid any action that discredits the profession

The Code makes it clear that warrant holders should be guided, not merely by the terms, but by the spirit of the Guide. Hence the fact that particular conduct does not appear among the list of examples and prohibitions does not necessarily mean that no ethical conflict exists.

The value of the Framework Approach is that the user will evaluate whether an act or decision is in accordance with the fundamental principles. The Code further requires the warrant holder to consider qualitative as well as quantitative factors.

The factors to be considered include:

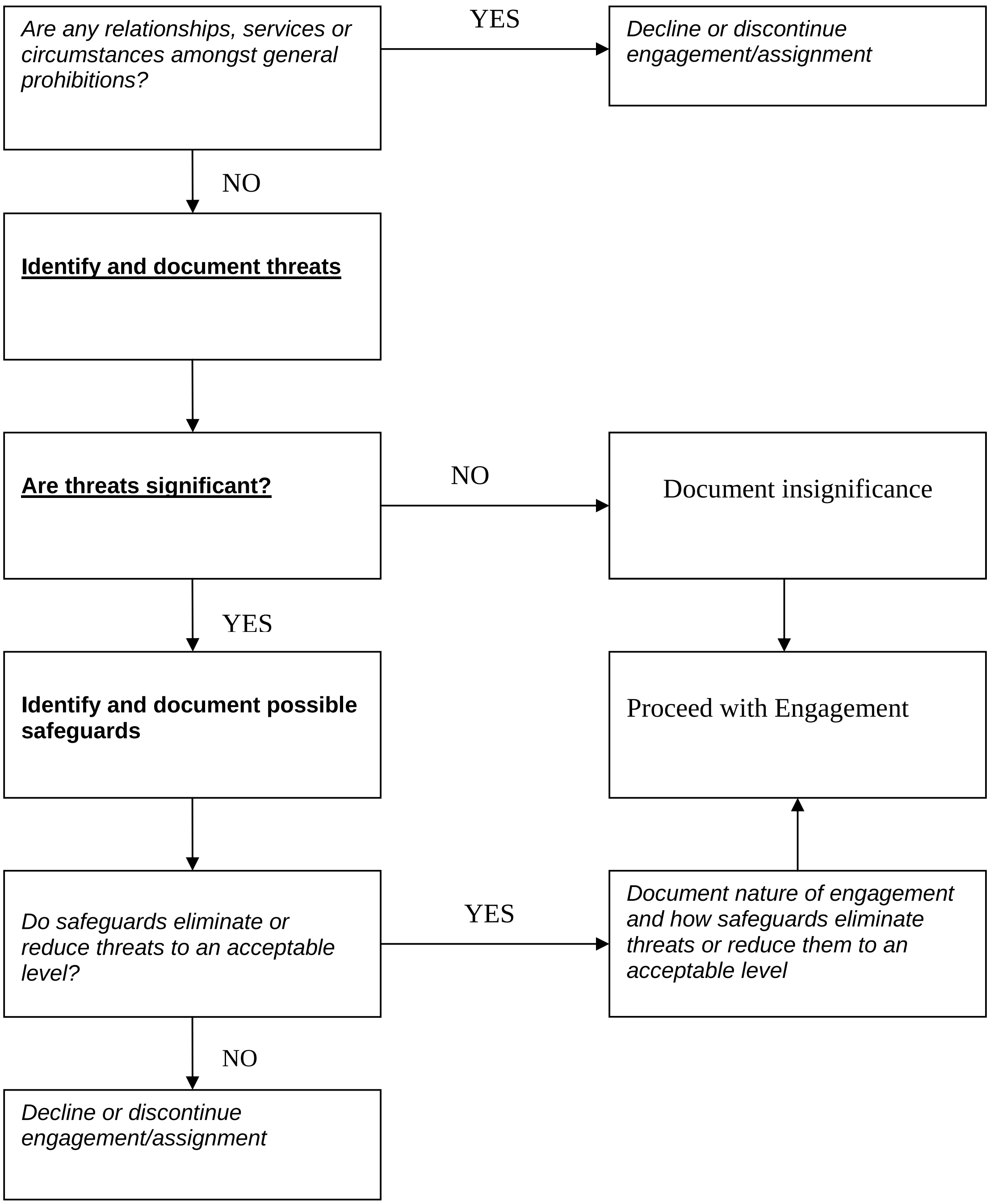
- The expectations of those directly affected (and entitled to be affected) by the work.
- The public interest and its bearing on the work.
- The threats to objectivity, existing and potential.
- The safeguards which are in place or can be put in place, overt or otherwise, to effect the threats

So what process should warrant holders follow? The following are the key steps in the decision making process.

- Identify the threats.
- Evaluate the significance of each threat identified;
- Determine if there are any prohibitions that preclude performing the engagement;
- For each threat identified which is not clearly insignificant, document the threat and a description of the safeguard applied and an explanation as to how it eliminates or reduces the threat to an acceptable level. This will include recording a decision not to perform the function.

This ethical decision making process is summarised in the following flowchart.

Framework for Ethical Decision Making – Flowchart



2. The Code of Ethics

Introduction

Warrant holders are required to comply with the Code of Ethics issued by the accountancy Board. The Board has ensured the Code complies with the pronouncements issued by the EC and IFAC.

Warrant holders are thereby assured that by complying with the Accountancy Board's requirements all these other pronouncements have been complied with.

The Provisions in relation to Independence

Independence is specifically covered in Part B Section 8.

The independence requirements apply to the warrant holder and to all members of the assurance team, including all those who are in a position to influence the outcome of the assurance engagement.

This section refers to all assurance engagements of which the audit engagement is a sub set. However additional specific provisions are in certain circumstance included for audit engagements and in some case for audit engagements where the client is a public interest entity.

Independence requirements for Assurance Engagements

It has already been identified that the threats to independence will be greater depending on the level of risk associated with the engagements. Audit is of itself higher risk than other assurance services and thus the extent of the threats and the safeguards will differ in relation to assurance than to audit. This can be extended further in relation to whom the assurance services are provided hence the provision of assurance services to audit clients carries greater threats to independence than the provision of assurance services to non audit clients.

Accordingly:

- for assurance engagements provided to an audit client, the warrant holders of the assurance team, the firm and the network firms are required to be independent of the client;
- for assurance engagements provided to clients that are not audit clients, when the report is not expressly restricted for use by identified users, the warrant holders of the assurance team and the firm are required to be independent of the client; and
- for assurance engagements provided to clients that are not audit clients, when the assurance report is expressly restricted for use by identified users, the warrant holders of the assurance team are required to be independent of the client. In addition, the firm should not have a material direct or indirect financial interest in the client.

These independence requirements for assurance engagements can be summarised as follows:

Parties needing to be independent	Type of assurance engagement
Assurance team	All assurance engagements
Firm	Assurance engagements where there is not a restricted use report. For assurance engagements for non-audit clients, where there is a restricted use report, the firm does not need to comply with the full independence requirements of this Statement but should not have a material direct or indirect interest in the client
Network firms	All assurance engagements for audit clients

Application of the Principles to Specific Circumstances

The Code includes examples describing specific circumstances and relationships which may create threats to independence, describing the potential threat and safeguards that may be appropriate.

The circumstances covered include:

- Financial Interests
- Loans and Guarantees
- Close Business Relationships with Assurance Clients
- Family and Personal Relationships
- Employment with Assurance Clients
- Recent Service with Assurance Clients
- Serving as an Officer or Director on the board of an Assurance Client
- Long association of senior Personnel with the Assurance Client
- Provisions of Non Assurance Services to Assurance Clients
- Fees and Pricing
- Gifts and Hospitality
- Actual or Threatened Litigation

3. Independence for Auditors

Introduction

Section 8 addresses the independence requirements for all assurance engagements however it is recognised that if the assurance client is an audit client then the risk is heightened and thus additional restrictive provisions have been included.

It is not possible in this session to discuss all the provisions of the Code however as a result on the Quality Assurance visits a number of issues which require clarification have come to light and will form the basis of discussion in this section of the paper.

These are:

- Provision of Non-Assurance Services to Assurance Clients
- Long Association of Senior Personnel with the Assurance Client

Provision of Non Assurance Services to Assurance Clients

The Code acknowledges that firms have traditionally provided non assurance services to their assurance clients and that in many cases the provision of these services has resulted in the assurance team having a greater understanding of the clients business and operations and hence their systems and controls.

It is however recognised that the provision of such services may create a threat to the independence of the firm, the network firm and members of the assurance team. It is therefore necessary to consider the threats and determine if safeguards are available if the threats are other than clearly insignificant.

In general, independence would be compromised if:

- The firm network firm or member of the assurance team become involved in making management decision: or
- Where the non assurance service resulted in the firm, network firm or member of the assurance team making assumption or giving advice which involved a great degree of subjectivity on the part of the firm etc.

However, the Code has identified a number of areas where the threat is so great that no safeguard is considered appropriate and hence the activity is prohibited. In this regard you should refer to paragraph 8.166 provision of accounting services to audit clients that are public interest entities; 8.171 valuation services; 8.199 corporate finance services.

<u>Accounting Services</u>
Where an audit client is not a public interest entity the firm and network firm may only provide accounting services that are of routine and mechanical nature and appropriate safeguards including evidence of management decision making is retained.

In relation to audit clients which are public interest entities the Code prohibits the provision of accounting services. The only exception is for emergency situations as set out in paragraph 8.168. In relation to subsidiaries of public interest entities

A table summarizing the types of accounting services which may be provided by a firm and the action required by the firm is included in part 7 of this paper.

Long Association of Senior Personnel with Assurance Clients

The Code does not require the rotation of senior personnel other than for audit clients that are public interest clients.

However, the Code recognises that using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threat. The significance of the threat must be assessed and if the threat is other than clearly insignificant, safeguards will need to be introduced. In general, for non public interest audit clients, the threat will be clearly insignificant and safeguards will not be necessary. I refer to the Section 6 Questions and Answers and in particular Question 4.

In relation to public interest entities the lead audit engagement partner must not continue as such for a period of more than 7 years and must not return to this position until a period of 2 years has elapsed. There are some relieves in this regard, for example, where the continuation of the lead engagement partner for a further defined period is essential to the audit or where a firm has only a few partners with the knowledge to perform the engagement. In these cases other safeguards may be used such as involvement of another professional accountant from within or outside the firm.

4. The Prohibitions

This table summarises the prohibitions contained in the Code. <u>However a word of caution!</u> These should not be read in isolation as they are provided as a quick reference tool. Please do not assume if a situation is not listed that it is acceptable as the table does not include those activities which are permitted only after the application of appropriate safeguards.

Ref	General Prohibition	Additional provisions for Public Interest Entities
Financial Interests		
8.104	A member of the assurance team or a close family member cannot hold a direct or material indirect financial interest in an assurance client	
8.111 & 8.112	Firm or a network firm cannot hold a direct or a material indirect financial interest in an audit client	
8.113	Firm and network firm cannot hold a material financial interest in an entity which has a controlling interest in the audit client.	
8.115	Partners, including those who do not perform assurance engagements, or their immediate family, in the office where the lead engagement partner practices in connection with the audit, cannot hold a direct or material indirect financial interest in the audit client	
8.117	Partners and managerial employees who provide assurance services, other than those which are clearly insignificant, to the audit client or their immediate family cannot hold a direct or material indirect financial interest in the audit client	
Loans and Guarantees		
8.124	A firm cannot accept a loan or guarantee from an assurance client that is a Bank unless under normal lending procedures and loan is immaterial to both parties	
8.125	A member of the assurance team cannot accept a loan or guaranteed from an assurance client that is a bank unless it is under normal lending procedures	
8.127	A firm or a member of the assurance team cannot make a loan to an assurance client that is not a bank or guarantee such an assurance clients borrowings unless the amount is immaterial to all parties concerned.	
8.128	A firm or a member of the assurance team cannot accept a loan from an assurance client that is not a bank or have a borrowing guarantees by an assurance clients borrowings unless the amount is immaterial to all parties concerned.	

Close Business Relationship		
8.130	A close business relationship between the firm and an assurance client is prohibited unless the financial interest is immaterial and the business relationship is clearly insignificant to all parties.	
8.130	A close business relationship between the firm, the network firm and the audit client is prohibited unless the financial interest is immaterial and the business relationship is clearly insignificant to all parties.	
8.130	No member of the assurance team can have a close business relationship with an assurance client unless the financial interest is immaterial and the business relationship is clearly insignificant to all parties.	
Family and Personal relationships		
8.134	No person can be a member of the assurance team when an immediate family member is a director, officer or employee of an assurance client and is in a position to exert direct and significant influence on the subject matter of the assurance engagement.	
Recent service with an audit client		
8.143	No person may be a member of the assurance team if they have been a director or officer of the assurance client at any time in the preceding two years.	
	Serving in a Key Management Position	
8.145	A period of two years must have elapsed before a lead engagement partner can take up a key management position for an assurance client	
Long Association of Senior Personnel with the Assurance Client		
8.148		The lead engagement partner must rotate after a pre-defined period of no more than 7 years and must not resume the position until a further 2 year period has elapsed
Provision of Non-Assurance Services to Assurance Clients		
	Preparing Accounting Records and Financial Statements	
8.162	The firm or network firm's personnel cannot provide any assistance to an assurance client which could be interpreted as their having made management decisions. This section sets out what is deemed to be management decisions.	
8.166		The firm and the network

		firm cannot provide accounting or bookkeeping services, including payroll services and the preparation of financial statements or the financial information which form the basis of the financial statements on which the audit report is provided on behalf of an audit client that is a public interest entity. The only exception is in emergency situations
	Valuation Services	
8.171	A firm or network firm cannot provide valuation services which involve the valuation of matters material to the financial statements and the valuation involves a significant degree of subjectivity.	
	Corporate Finance	
8.199	A firm or network firm cannot provide corporate finance services to an assurance client where they involve: (i) promoting, dealing in, or underwriting of an assurance client shares: or (ii) committing the assurance client to the terms of a transaction or consummating a transaction on behalf of the assurance client.	
Gifts and Hospitality		
8.210	A firm or a member of the assurance team should not accept gifts or hospitality form an assurance client unless the value is clearly insignificant.	

5. Safeguards - Examples

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

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

Safeguards fall into three broad categories:

- safeguards created by the profession, legislation or regulation;
- safeguards within the assurance client; and
- safeguards within the firm's own systems and procedures.

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

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

- educational, training and experience requirements for entry into the profession;
- continuing education requirements;
- professional standards and associated monitoring and disciplinary processes;
- external review of a firm's quality control system; and
- legislation governing the independence requirements of the firm.

Safeguards within the assurance client include the following:

- when the assurance client's management appoints the firm, persons other than management ratify or approve the appointment;
- the assurance client has competent employees to make managerial decisions;
- policies and procedures that emphasise the assurance client's commitment to fair reporting;
- internal procedures that ensure objective choices in commissioning other assurance and non-assurance engagements; and
- a corporate governance structure that provides appropriate oversight and communications regarding a firm's services.

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

- leadership that stresses the importance of independence and the expectation that warrant holders of assurance teams will act in the public interest;
- policies and procedures to implement and monitor quality control of assurance engagements;
- documented independence policies regarding the identification of threats to independence, the evaluation of the significance of these threats and the

identification and application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level;

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

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

- involving an additional member to review the work done or otherwise advise as necessary. This individual could be someone from outside the firm or network firm, or someone within the firm or network firm who was not otherwise associated with the assurance team;
- consulting a third party about potential issues, such as a committee of independent directors, a professional regulatory body or another professional;
- rotation of senior personnel;
- discussing independence issues identified with the client's audit committee or others charged with governance;
- disclosing to the audit committee or others charged with governance, the nature of services provided and extent of fees charged;
- policies and procedures to ensure warrant holders of the assurance team do not make, or assume responsibility for, management decisions for the assurance client;
- involving another firm to perform or re-perform part of the assurance engagement;
- involving another firm to re-perform the non-assurance service to the extent necessary to enable it to take responsibility for that service; and
- removing an individual from the assurance team for a particular engagement (by prohibition or self-exclusion from direct participation by those in a position to exert influence), when that individual's financial interests or relationships create a threat to independence.

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

6. Questions and Answers

Q1.	**Can we provide non audit services to our audit clients?**
A	Paragraph 8.152 commences the discussion on the provision of non assurance services to audit clients and sets out the general threats and safeguards approach whilst recognising that certain non assurance services create threats of such significance that no safeguard can be applied. Therefore although there is no outright prohibition generally you should consider precisely what services you are providing and the clients to whom you are providing them to on a case by case basis. In particular, you should establish if you have not already done so, procedures to identify new engagements for audit clients and assess whether these engagements have an adverse impact on actual or perceived independence for such clients. You must consider whether the purpose of the engagement is consistent with the audit, what threats to independence exist, the availability and effectiveness of safeguards and document the reasons for your decision to act. You should also review the Code carefully as depending on the nature of the non assurance service there are a number of additional provisions and in certain cases prohibitions.
Q2	**Can I provide accounting services to a public interest client (PIE)**
	An audit firm can only provide accounting services to a PIE in very exceptional situations. These might include emergencies for example created by an unexpected serious illness or death of a key accounting individual within the client. (see 8.166) With regard to other clients an audit firm should not undertake an engagement to provide accounting services to its client where those services would involve the firm taking management decisions. With the provision of such services appropriate safeguards will be necessary to safeguards against such matters as self review or taking management decisions (see 8.165)
Q3	**Will we have to give up our audit clients, many of whom are managed small entities simply because we have acted for them over a prolonged period?**
	The general provisions on auditor rotation are set out in the Code in paragraph 8.147. In general terms a long association with an audit client is considered a potential threat to the independence and objectivity of the auditor. This has always been recognised as a threat to independence and objectivity. In some circumstances this threat can be managed by putting in place appropriate safeguards but in other cases it would be inappropriate for the auditors to accept or continue the audit engagement. It is therefore important to have in place policies and procedures to monitor the period that audit engagement partners and other staff are part of the engagement team for each audit. What action is taken will depend on the role of the individual in the team, the proportion of their time spent on the audit client, the length of time associated with the audit engagement and the type of client. Potential safeguards include rotation, additional partner review or independent internal quality reviews. In relation to public interest entities there are detailed specific prohibitions (paragraphs 8.148-8.151) on different personnel acting for prolonged periods. For

	example no one should act as audit engagement partner for longer than seven years.
Q4.	**There has been a lot of publicity on auditor rotation – what are the rules?**
	The Code distinguishes between public interest entities (paragraphs 8.148-8.151) where the provisions are more stringent & all other companies (paragraph 8.147). The audit firm should establish policies & procedures to monitor the length of time that key & senior staff serve as members of the audit engagement team. You should assess long associations & where the threats are other than clearly insignificant, you should apply safeguards to reduce threats to an "acceptable level". If appropriate safeguards cannot be put in place then firms should either resign or not stand for reappointment as appropriate. You should consider factors such as the role of given individuals, the time that the audit client contributes to individuals' billable hours & the length of association with the audit. (Para 7). In order to address such threats the Code suggests safeguards such as rotation of staff. **Generally - audit engagement partner position held continuously for 10 years**: • There is no presumption that there should be rotation • Where there is no rotation, either need to document safeguards (for example: involving an additional partner not involved on the engagement, or applying an independent quality review) or document reasoning and discuss with client. • In the latter case, the reasoning would typically be a statement as to why safeguards are not necessary, for example: "I am able to continue giving an objective opinion as there are no significant subjective issues on this client. If any arise I will take external advice" **Public Interest Client-lead engagement partner after 7 continuous years**: • Rotate engagement partner off • Prevent return to position further 2 years
Q5.	**I am a sole practitioner what are the audit rotation rules for me?**
	While there is no presumption that there should be rotation. Generally where you have been the auditor continuously for say 10 years or more, unless the threats are other than clearly insignificant, you will need to consider and apply safeguards to mitigate the threats posed by your long association with the client. As partner rotation is not an option in your case, you either need to - document safeguards (for example: involving another practitioner, for example your continuity nominee or applying an external independent quality review; **or** - document and discuss with client your reasons for continuing as auditor.
Q6	**We rent premises from our audit client. It is a purely commercial transaction but the rental income may be material to the client. Can we act?**

	Such a relationship would create a potential threat to your objectivity as auditor. If the arrangements are in the ordinary course of business and on an arm's length basis and the value is not material to either party you would be able to continue to act. In this case however, it appears that the rental income may be material to the client. You will therefore need to establish whether or not this is the case and if it is then you will need to take immediate steps to terminate either the client or business relationship. (see 8.130)
Q7.	**I work as a sole practitioner and an immediate family member is a principle in another firm which provides book keeping services to a number of my non public interest audit clients. Is this in breach of the Code?**
	Section 8.134 states that: '*When an immediate family member of a member of the assurance team is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement, or was in such a position during any period covered by the engagement, the threats to independence can only be reduced to an acceptable level by removing the individual concerned from the assurance team. The closeness of the relationship is such that no other safeguard could reduce the threat to independence to an acceptable level. If application of this safeguard is not used, the only course of action is to withdraw from the assurance engagement. <u>For example, in the case of an audit of financial statements, if immediate family members or spouse of a member of the assurance team is an employee in a position to exert direct and significant influence on the preparation of the audit client, accounting records or financial statements, the threat to independence could only be reduced to an acceptable level by removing the individual concerned from the assurance team.</u>* The Code of Ethics would prohibit the immediate family memebr from undertaking any activities which could not be provided by the firm. The firm can assist in the preparation of financial statements only if the criteria set out in the Code is met. If the connected person (the wife) was involved in any management functions for example, coding the accounts, issuing invoices, etc, this would be unacceptable as this could not be undertaken by the firm. In this case, it appears the connected person has a very important role in determining the accounting entities and as such this would not comply with the provisions of the Code.
Q8.	**My practice assists in the preparation of financial statements to a public interest entity. Is this acceptable?**
	The Ethical Code, para 8.166 states that in respect of audit clients that are public interest entities "*The provision of accounting and bookkeeping services, including payroll services and the preparation of financial statements or financial information which forms the basis of the financial statements on which the audit report is provided, on behalf of an audit client that is a public interest entity, may impair the independence of the firm or network firm, or at least give the appearance of impairing independence. Accordingly, no safeguard other than the prohibition of such services, except in emergency situations and when the services fall within the statutory audit mandate, could reduce the threat created to an acceptable level.* Hence these activities are prohibited.

7. Accounting Services

One of the areas of greatest concerns to practices providing accounting services to clients (other than public interest entities) is the identification of exactly what they can do that does not result in them making management decisions. The table which follows seeks to provide some guidance as to what practitioners should do to ensure the appropriate level of client involvement.

Again a note of caution this is guidance only and practitioners should carefully consider the Code and the nature of the function they are performing to ensure that they comply with the provisions of the Code.

	Accounting Service	Need to ensure management involvement	Not Allowed	Comment This will include nature of safeguard and evidence necessary to confirm 'informed management'
1.	Preparing financial statements based on information in the trial balance.	X		Management will need to be informed of any amendments to be made to the trial balance information. This can be done by way of presentation of the final journals for management approval. If you are adding information of a material or subjective nature not arising from the client's original documentation then additional safeguards may be required.
2	Preparing source documents for the client.		X	
3	Authorising or approving transactions.		X	
4	Posting client approved entries to the trial balance.	X		See 1 above.
5	Recording of transactions when management has determined or approved the account classification, or posting client-coded transactions to the general ledger.	X		It is recommended that to evidence management's approval a file note of the first instructions showing the client's intentions is documented. This can be done in summary rather than for every item individually. For example, you could, with management, identify the main suppliers and agree the account classifications. Further instructions would therefore only be required in the event of a new supplier invoice. Additionally, further summary instructions are recommended to be obtained for significant matters or items which go beyond the routine (first) instructions.

	Accounting Service	Need to ensure management involvement	Not Allowed	Comment This will include nature of safeguard and evidence necessary to confirm 'informed management'
6	Determining or changing journal entries, account coding, or classification for any accounting record without client approval.		X	
7	Making changes to source documents without client approval.		X	
8	Approving purchase invoices for payment.		X	
9	Completing the VAT return for the client where the client has maintained the source books and records.	X		Management need to be informed and approve of any changes made to the information presented by them. Additional safeguards may be required if adding information of a material or subjective nature not arising from the client's original documentation. *Firms should not sign the form on behalf of the management.*
10	Preparing primary books and completing the VAT returns from invoices presented by the client.	X		The same criteria applies as discussed in 5 above. Additional safeguards may be required if adding information of a material or subjective nature not arising from the client's original documentation. Firms should not sign the form on behalf of the management.
11	Proposing standard, adjusting, or correcting journal entries that affect the financial statements provided the client reviews and understands the nature and the impact of the entries.			See 1 above Additional safeguards may be required if adding information of a material or subjective nature not arising from the client's original documentation.
12	Authorizing or approving disbursements for payroll or payroll taxes.		X	

	Accounting Service	Need to ensure management involvement	Not Allowed	Comment This will include nature of safeguard and evidence necessary to confirm 'informed management'
13	Using client-provided and client-approved time records, generating unsigned cheques, or processing client's payroll.	X		The client must authorise the payroll in writing and this should be documented on file. It is sufficient to have this approval once if the payroll is constant. If payments fluctuate significantly on a weekly (or monthly) basis, for whatever reason, it is recommended that the client's approval is obtained on a weekly basis. Such variances may occur due to changes in the number of hours worked; changes in pay rates etc.
14	Transmitting payroll information to a bank or other financial institution when the client has authorized the member to make the transmission and has arranged for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, the client must authorize the financial institution to process the information following transmission.	X		As 13 above.
15	Authorising payments for payroll (including remittances to the Revenue for PAYE) for the client using the online payment system.	X		Authorisation for payments must be received from management. The firm can transmit the payment provided authorisation has been given. Authorisation does not need to sought in each individual instance provided: • specific instructions are documented. • that these instructions cover approval and any limits that may be applicable. • that if the payroll if being processed in full on behalf of the client that the procedures in 13 above are applied.

	Accounting Service	Need to ensure management involvement	Not Allowed	Comment This will include nature of safeguard and evidence necessary to confirm 'informed management'
16	Preparing and filing, including electronic filing, PAYE returns on behalf of the client.	X		Management is responsible for the information contained in the return. If the payroll is processed by the firm and the procedures in 13 above are applied then specific approval of the information is not required provided that general approval for the submission of the form has been received and is documented. If the firm has not been responsible for the payroll management must approve the information on the return prior to submission.
17	Preparing and filing, including electronic filing, Corporation Tax Returns on behalf of the client.	X		Management is responsible for the information on the return. The information to be included on the return must therefore be discussed with management, this can be done when completing the audit. Further approval is not required unless there is any material change in the position as reported to management at that time.
18	Transmitting payment of corporation tax due on behalf of the client, including electronic payment.	X		Authorisation of payment must be received from management before the remittance of any amount.
19	Preparing government remittance forms for client approval.	X		Additional safeguards may be required if adding information of a material or subjective nature not arising from the client's original documentation. It is recommended that specific instructions are documented.
20	Signing government remittance forms on behalf of client management.		X	In general this is not permitted. Please call the helpline for specific advice.
21	Preparing cheques for client approval and signing.	X		Specific instructions should be documented.

	Accounting Service	Need to ensure management involvement	Not Allowed	Comment This will include nature of safeguard and evidence necessary to confirm 'informed management'
22	Preparation of periodic management accounts	X		There may be additional safeguards required if adding information of a material or subjective nature not arising from the client's original documentation. Care must be taken to ensure that the firm does not become involved in a management function. For example the regular production of management accounts could result in a self review threat requiring additional safeguards.
23	Preparation of consolidated accounts	X		There may be additional safeguards required if adding information of a material or subjective nature not arising from the client's original documentation. It is recommended that specific instructions are documented.
24	Attendance at the Board meeting at which the management accounts are presented	X		Care must be taken to ensure that the firm does not become involved in a management function. The firm should provide clarification on the figures in the accounts but should not be involved in any decision making resulting form the consideration by the Board of the management accounts.