

# Independent minds

Different independence and objectivity requirements for different types of engagements can cause confusion. **Madeleine Fone** provides some clarification



## HELP AND ADVICE ON ETHICS

Ethics isn't just about the big issues that hit the headlines. It's about everyday professional choices, and some of these can be easier to make than others.

The Ethics Advisory Service can help you to work through any ethical issues that arise in the course of your professional life. The team know the *Code of Ethics* and related guidance inside out and can not only direct you to the relevant sections but can talk through the issues in a structured way and help you to reach a well-reasoned decision on how to proceed.

Also, the Ethics Advisory Service addresses a number of frequently asked questions in a series of helpsheets, which can be found at [bit.ly/1c4QoNY](http://bit.ly/1c4QoNY)

The ethics advisory team can be contacted on +44 (0)1908 248250 or email [ethics@icaew.com](mailto:ethics@icaew.com)

## QUESTION

### AUDIT, ASSURANCE REVIEW OR NON-ASSURANCE ENGAGEMENTS: HOW DO RELATIONSHIPS AFFECT INDEPENDENCE AND OBJECTIVITY REQUIREMENTS?

While some readers will be able to give the short answer to this question off the top of their head, this is an area where more detailed answers can surprise some callers to the Ethics Advisory Services helpline.

The short answer is: although the level of assurance may be different for audit and assurance engagements, the level of independence does not differ significantly.

While independence is not required for non-assurance engagements, objectivity is nevertheless a fundamental principle of the ICAEW *Code of Ethics* for all engagements. Hence the firm must maintain objectivity in its approach to the compilation assignment.

The long answer depends on various criteria, including the relationships between members of the firm, the client, and connections such as family members.

## ANSWER A

### IF A STAFF MEMBER IS AN OFFICER OR EMPLOYEE OF THE CLIENT

#### Audit

All statutory auditors are familiar with the Companies Act 2006 requirement for auditor independence. One aspect of this is the prohibition on acting as an auditor to an entity where an employee of the audit firm is an officer of the audited entity in s1214 (s1173 defines 'officer' as a director, manager or secretary). This is also reflected in the Financial Reporting Council's *Ethical Standards for Auditors* ([bit.ly/1ppcDBr](http://bit.ly/1ppcDBr)); in particular, in ES2 *Financial, business, employment and personal relationships* para 54.

#### Assurance Review Engagement

When an ICAEW chartered accountant undertakes any assurance engagement that is a review engagement the independence requirements of the ICAEW *Code of Ethics Independence - audit and review engagements* must be met.

The *Code of Ethics* and related material is at [bit.ly/1bj9TuY](http://bit.ly/1bj9TuY)

Tech 09/13AAF Assurance review engagements on historical financial statements (which replaces the ICAEW Assurance Service as set out in AAF03/06) provides guidance on determining that an 'assurance engagement' is a 'review engagement' ([bit.ly/OyMxht](http://bit.ly/OyMxht)).

Para 4 of the appendix to section 290 of the ICAEW *Code of Ethics* says:

"Taken together, the key elements in determining that an assurance engagement is a review engagement are:

- the subject matter - historical financial information; and
- the nature of the report - limited procedures but nothing has come to attention to indicate the information is not prepared in accordance with applicable financial reporting framework."

Thus, s290 of the *Code of Ethics* applies to review engagements (albeit that it refers to 'audit'). It is worth noting that although paragraph 290.0c explains that accountants may, if more convenient, apply the independence requirements of the APB *Ethical Standards for Auditors* (APB ES), and therefore make use of the APB *Provisions Available for Small Entities* (PASE), s290.146 says: "no partner or employee shall serve as a director or officer of an audit client," and PASE does not provide anything in relation to this.

Although there are independence guidelines for an Independent Examination of a charity given in the

Charity Commission guidance CC32, when an ICAEW chartered accountant undertakes an Independent Examination, the independence requirements of s290 of the ICAEW *Code of Ethics* also need to be met.

For example, if the Independent Examination is being undertaken as part of the business activities of the firm (albeit signed in person by the Independent Examiner), the firm also needs to be mindful of connections that employees of the firm have with the charity.

As s290 of the *Code of Ethics* applies to review engagements, as outlined above, if the firm has a member of staff who is a trustee of a charity, then the firm is prohibited from undertaking the Independent Examination.

#### Other assurance engagements

For assurance engagements that are not 'review engagements' the guidance in the *Code of Ethics* is given in s291 *Independence - other assurance engagements*. However, maybe surprisingly, the prohibition on any employee of the firm being a director or officer of the assurance client remains – s291.135 says: "No partner or employee shall serve as a director or officer of an assurance client".

#### Non-assurance engagement

For compilation engagements such as preparing year-end financial statements - section 280 *Objectivity - all services of the Code of Ethics* applies.

In the section of the *Code of Ethics* on general application, s120.1 says:

"The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgement because of bias, conflict of interest or the undue influence of others."

The onus for a compilation assignment is to evaluate the significance of any threats and apply safeguards when necessary to eliminate them or reduce them to an acceptable level. If the threats cannot be reduced to an acceptable level then the firm should not undertake the engagement.

If a principal in a small firm is also a director of a client company the self-interest threat is significant as the relationship may bias judgement with respect to the firm's services.

An example of a safeguard that in certain circumstances might be able to reduce the threat to objectivity to an acceptable level would be for a year-end assurance review service to be provided to the client by a third party firm. The assurance service of the independent firm will underpin the bookkeeping firm's objectivity. Likewise, disclosure of the relationship in writing to HMRC will act as a safeguard when a firm is acting as tax agent.



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## ANSWER B FAMILY AND OTHER CONNECTIONS

### Audit

If an immediate or close family member of an audit team member becomes an officer of the audited entity, then the audit team member needs to be removed from a position where they can exert influence over the audit (ES2 para 55). The firm also needs to address perception - ie, whether a reasonable and informed third party would conclude that the auditors' objectivity is impaired or is likely to be impaired (ES2 para 56).

### Non-audit assurance

Likewise, immediate family members of members of the non-audit assurance team cannot be officers of the audited entity (s290.128 and s291.122) Neither can

immediate family members of the assurance team be in a position to exert influence over the subject matter of the assurance engagement.

There is a slight relaxation for non-audit assurance engagements, in as much as close family members of the assurance team with such roles at the audited entity are subject to a 'threats and safeguards' approach. Immediate family are spouses (and equivalent) or dependents. Close family are parents, children or siblings that are not immediate family members.

For assurance assignments, consideration also has to be given to 'close relationships' (s290.131 and s291.125). This may need to be considered when members undertake voluntary

roles as Independent Examiners where they also have strong personal connections to the charity. The examiner needs to consider whether they would be sufficiently independent to, say, make an unfavourable report - or indeed to resign if circumstances warrant it. The personal impact of such actions is frequently more than insignificant. Self-interest threats to independence in this context might be any 'other interest which might cause the auditor to be reluctant to take actions'.

### Non-assurance engagement

As we have seen above, for a compilation report assignment the approach is assessing 'threats and safeguards' to objectivity. ■