



# AUDIT NEWS

## Issue 52

### Trustee shareholdings in audit clients

A number of firms have principals holding trustee appointments for their clients. In some cases, the trusts may have shareholdings in the firm's audit clients. These situations present a threat to firms' independence and the threat may, in some cases, be too great to safeguard.

The Audit Registration Committee (ARC) generally takes a tough line on independence issues and has recently considered a number of cases involving trustee shareholdings. Some firms have been given regulatory penalties for failing to deal with these situations appropriately.

APB Ethical Standard 2 has a separate section covering trustee shareholdings in audit clients (ES 2 paragraph 19). It says that a person in a position to influence the audit (or an immediate family member of such a person) should not be a trustee of a trust holding shares in an audit client unless certain criteria are met. Before considering these criteria, the firm needs to determine whether the trustee is in a position to influence the audit. This may not be straightforward.

### Potential pitfalls and how to avoid them

#### Make sure you understand the definitions

The APB glossary's definition of **Person in a position to influence the audit**:

(a) Any person who is directly involved in the audit (the engagement team), including:

- the audit partners, audit managers and audit staff (the audit team);
- professional personnel from other disciplines involved in the audit (for example, lawyers, actuaries, taxation specialists, IT specialists, treasury management specialists);
- those who provide quality control or direct oversight of the audit;

(b) Any person, who forms part of the chain of command for the audit within the audit firm;

(c) Any person within the audit firm who, due to any other circumstances, may be in a position to exert such influence.

**Chain of command** is defined as:

All persons who have a direct supervisory, management or other oversight responsibility over either any audit partner of the audit team or over the conduct of audit work in the audit firm. This includes all partners, principals and shareholders who may prepare, review or directly influence the performance appraisal of any audit partner of the audit team as a result of that partner's involvement with the audit engagement. It does not include any non-executive individuals on a supervisory or equivalent board.

Firms don't always realise these are defined terms and, as a consequence, may:

- interpret their meaning too narrowly;
- not identify a threat where it exists; and
- conclude incorrectly that a trustee partner is not in a position to influence the audit.

## Key points

**Person in a position to influence the audit** is not limited to direct involvement in the audit.

A principal who is responsible for appraising the RI is considered to be in the **chain of command**.

Any senior principal in a firm is likely to be considered to have influence over a more junior principal unless the firm can demonstrate this isn't the case.

The spouse (or equivalent) or dependent of a person in a position to influence the audit is considered to be in the same position of influence.

## Perception is important

Someone outside the firm may perceive that any principal in the firm could exert influence over another. So, even if the firm considers that it has addressed any threat, it should also consider how the situation looks from the outside. Factors such as whether the trustee works in the same office as the RI may be relevant for this purpose.

If the firm decides that the trustee is not in a position to influence the audit, there is one further restriction; the trustee (or the trustee's spouse or dependent) cannot also be a beneficiary of the trust.

## What if the trustee is in a position to influence the audit?

If the trustee is considered to be in a position to influence the audit, the situation is only tenable if the following criteria are met:

- the relevant person is not an identified potential beneficiary of the trust; and
- the financial interest held by the trust in the audited entity is not material to the trust; and
- the trust is not able to exercise significant influence over the audited entity or an affiliate of the audited entity; and
- the relevant person does not have significant influence over the investment decisions made by the trust, in so far as they relate to the financial interest in the audited entity.

So, if all these criteria are satisfied, there shouldn't be a problem. But care is needed.

The most likely sticking point is materiality to the trust. The shareholding in the audit client may well be the sole asset of the trust, in which case the interest would be considered to be material, whatever the actual value of the shares. If there are any doubts, the matter should be referred to the firm's ethics partner, or the firm should consult externally. This could be with ICAEW's ethics helpline (T: +44 (0)1908 240 250) or with another firm of suitable experience.

## If these criteria aren't satisfied

The firm should take prompt action. The choice will be either to resign from the audit or for the trustee to resign the trustee appointment. The firm may be able to identify another suitable individual within the firm who can take over the trustee appointment as long as there are no chain of command or other influence issues.

## Conclusion

This is a tricky area. It's essential for firms to familiarise themselves with the relevant parts of ES2 and the **APB glossary**.

If in any doubt, consult!

The ARC uses ICAEW's **Guidance on sentencing** to set the level of regulatory penalties.