



# *Crown Dependencies' Audit Rules and Guidance*

EFFECTIVE FROM 15 MARCH 2020

## ABBREVIATIONS

The following abbreviations are used in this booklet:

CPD	Continuing professional development
FRC	Financial Reporting Council
ISA	International Standards on Auditing (UK)
ISQC1	International Standard on Quality Control (UK) 1
PII	Professional indemnity insurance

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## INTRODUCTION

1. These rules apply to recognised auditors that audit market traded companies incorporated in a Crown Dependency. The rules set standards that such auditors must follow and are a key part of a framework in each Crown Dependency for the oversight of auditors that audit market traded companies. The Institute (or any other body approved by the relevant registrar) will monitor the compliance of auditors with the rules. The rules provide for the Institute to take disciplinary action against an auditor where a breach of the rules occurs. In addition, the Companies Law in each Crown Dependency provides for the registrar of recognised auditors to be able to apply sanctions against auditors in specified circumstances (including where a breach of the rules occurs). Ultimately (subject to an appeal to the courts), the registrar in each Crown Dependency has the power, in appropriate cases, to revoke a recognised auditor's registration to audit market traded companies.
2. These rules and associated guidance are based on the Institute's 2017 Audit Regulations and Guidance. Because many auditors of market traded companies incorporated in a Crown Dependency are also registered auditors in the United Kingdom these rules use the same numbering convention as in the 2017 Audit Regulations. It is important to note however, that whilst the content of a rule herein may be similar to the regulation of the same number in the 2017 Audit Regulations there will, in most cases, be some necessary differences. Where a regulation in the UK Audit Regulations has no direct equivalent rule herein, the rule number will be annotated as 'not relevant'.
3. Recognised auditors must comply with the rules, which require them to:
  - carry out audit work with integrity;
  - be and be seen to be independent;
  - comply with auditing standards;
  - make sure that all principals and employees are fit and proper persons; and
  - make sure that all principals and employees are competent and continue to be competent to carry out audit work.
4. Guidance is given to help firms apply the rules. This is printed in light type and the rules are in **bold** type. Where the guidance is too long to be included with the rules, it has been put into part 2 of this booklet in separate guidance chapters.
5. As each firm is different, no guidance can be sufficiently comprehensive to cover all firms. Firms may develop other procedures to comply with the rules but it is compliance with the rules that is important.
6. The rules should be read in conjunction with:
  - the Institute's Code of Ethics (including the fundamental principles);
  - relevant publications issued by the Financial Reporting Council:
    - International Standards on Auditing (UK);
    - International Standards on Quality Control (UK) 1;
    - Ethical Standards;
  - (where appropriate) International Standards on Auditing, issued by the International Auditing and Assurance Standards Board (IAASB);
  - (where appropriate) Financial Reporting Standards issued by the Financial Reporting Council;
  - (where appropriate) International Financial Reporting Standards or the Generally Accepted Accounting Principles applicable to the relevant audit;
  - relevant parts of company legislation in the Crown Dependencies; and
  - the Professional Indemnity Insurance Regulations.

7. Schedule 1 to chapter 1 contains definitions and interpretation of the rules which apply both to the rules and the related guidance. A word or phrase which is defined in schedule 1 is printed in italics when used in the rules.
8. The rules set requirements on recognised auditors and these include, in certain circumstances, notifications that must be given to the Institute. Recognised auditors should note that Companies Law also sets requirements and these will include, in certain circumstances, notifications that must be given to the registrar. Recognised auditors should ensure that they make themselves aware of these statutory obligations.

## **Help and advice**

While recognised auditors must comply with the rules and the related pronouncements and guidelines, help and advice is available. The Institute and other organisations (such as training consortia) can offer advice and give practical help.

# *Part 1 - Audit rules*

## Chapter 1 - General

This chapter deals with the scope and interpretation of the rules.

The rules are printed in **bold** type and guidance in light type. Where defined terms (see schedule 1) are used in the rules they are printed in *italics*. This does not apply to the guidance.

Guidance is provided to help recognised auditors to comply with the rules. However, each firm is different and no guidance can be sufficiently comprehensive to deal with all firms. Firms may develop their own procedures to comply with the rules, but it is compliance with the rules that is essential.

A copy of any changes or amendments to the rules will be sent by the Institute to the audit compliance principal by email.

### Scope and status

**1.01** The *rules* apply to *firms* registered by the *registrar* as *recognised auditors* under the *Companies Law*. *Rule 4.01* applies the *rules* to *responsible individuals* of the *firm*. In certain instances the *rules* continue to apply notwithstanding that registration has ceased.

**1.02** [NOT RELEVANT]

**1.02A** [NOT RELEVANT]

**1.02B** [NOT RELEVANT]

### Definitions and interpretation

**1.03** The definitions of terms used in the *rules* and the interpretation provisions are in schedule 1 to this chapter. Section headings are not part of the *rules* and are for guidance only.

### Transitional arrangements

**1.04** The *rules* come into force on 15 March 2020 in respect of financial statements for accounting periods commencing on or after this date . From this date the *rules* (April 2010 edition, as amended) are no longer in force, subject to *rule 1.06*

**1.05** [NOT RELEVANT]

**1.06** The liability of a *recognised auditor* to regulatory or disciplinary action is to be determined in accordance with the *rules* in force at the time that the matter now the subject of

**regulatory or disciplinary action occurred, but the regulatory or disciplinary proceedings shall be conducted in accordance with the *rules* (including any subsequent amendments).**

The above means that whether or not there has been an 'offence' under the rules is determined by the rules in force at the time the 'offence' took place, but the process of dealing with the matter will be as set out in the rules (together with any subsequent amendments) in force at the time that the regulatory or disciplinary proceedings are invoked.

## **Notifications**

**1.07 Any notice or document may be served on the *Institute* by sending it to:**

**The Institute of Chartered Accountants in England and Wales:  
Professional Conduct Department  
Metropolitan House  
321 Avebury Boulevard  
Milton Keynes  
MK9 2FZ.**

**or as otherwise notified to *firms*.**

**1.08 Any notice, decision, order or other document which needs to be served on a *firm* or other person under the *rules* will be delivered by hand, or sent by fax, email or post:**

- a if it is delivered by hand to the addressee service will take effect immediately;**
- b if sent by fax, it will be sent to the latest fax number given by the addressee and service will take effect immediately; or**
- c if sent by post, it will be sent to the latest address given by the addressee and service will take effect two business days after posting.**
- d if sent by email, it will be sent to the latest email address notified by the addressee and service will take effect immediately.**

## **Guidance**

Guidance is provided to help with the application of the rules. It is distinguished from the rules by being in light type. In a few cases there is too much guidance to include it with the rules and so it is included in a separate section after the rules and cross-referenced.

The guidance is merely that. It is impractical to provide guidance for every situation that may arise and the rules may be complied with in different but equally valid ways. However, recognised auditors must always comply with the rules, which take precedence over the guidance.



# SCHEDULE 1 - DEFINITIONS AND INTERPRETATION

## Definitions

In the rules the following words have the following meanings.

Appeal Committee	<b>The committee of the <i>Institute</i> with responsibility for hearing appeals against a decision of the <i>Review Committee</i> under the <i>rules</i>.</b>
associate	<b>In relation to an entity, another entity in which it holds an interest on a long-term basis for the purpose of securing a contribution to its own activities by the exercise of control or influence arising from or related to that interest, or which holds such an interest in it. A holding of 20% or more is presumed to create an associate relationship.</b>
audit	<b>Any function in respect of a <i>market traded company</i> which is performed by a <i>recognised auditor</i> following appointment as auditor of that company in relation to its financial statements or extracts of financial statements as required by a listing authority or a recognised company stock exchange.</b>
audit client	<b>Any person whose accounts are being audited under the <i>rules</i> by a <i>recognised auditor</i>.</b>
audit compliance principal	<p><b>A <i>responsible individual</i> who is either a <i>principal</i> of the <i>recognised auditor</i> (or a sole practitioner where the <i>recognised auditor</i> is a sole practice) or a member of its <i>management board</i> who is responsible for monitoring that the <i>recognised auditor</i> has complied, and is likely to continue to comply, with the <i>rules</i>, and who is the first point of contact with the <i>registrar</i>, <i>Institute</i>, or a <i>monitoring unit</i>, in connection with the <i>rules</i>.</b></p> <p>The role of the audit compliance principal is to be responsible for ensuring that the firm complies with the rules. A major part of the responsibilities is to make sure the monitoring required by the rules is carried out. The audit compliance principal need not carry out the reviews personally but should make sure that they are carried out satisfactorily and any appropriate action taken.</p>
audit report	<b>A report by a <i>recognised auditor</i> which relates to an <i>audit</i>.</b>
auditing standards	<p><b>The basic principles and essential procedures (shown in bold type) in the International Standards on Auditing (UK) which are to be construed and applied having regard to the explanatory text and other material in those standards; issued by the Financial Reporting Council.</b></p> <p><b>Notwithstanding that the <i>rules</i> anticipate that an <i>audit</i> will be carried out in accordance with the International Standards on Auditing (UK), it is also acceptable for an <i>audit</i> to be carried out in accordance with International Standards on Auditing (issued by the International Auditing and Assurance Standards Board). The definition of <i>auditing standards</i> shall be construed accordingly.</b></p>

audit work	<b>Any work done by or on behalf of the <i>recognised auditor</i> in respect of an <i>audit</i>.</b>
audit working papers	<b>Material (whether in the form of data stored on paper, film, electronic media or other media or otherwise) prepared by or for, or obtained by the <i>recognised auditor</i> in connection with the performance of the audit concerned and includes –</b> <ul style="list-style-type: none"> <li><b>(a) the record of audit procedures performed;</b></li> <li><b>(b) relevant audit evidence obtained; and</b></li> <li><b>(c) conclusions reached.</b></li> </ul>
business day	<b>A day excluding weekends and public holidays.</b>
Bye-laws	<b>The bye-laws of the <i>Institute</i>.</b>
Companies Law	<b>In Jersey – the Companies (Jersey) Law 1991, as amended from time to time;</b>  <b>In Guernsey – the Companies (Guernsey) Law, 2008, as amended from time to time;</b>  <b>In the Isle of Man – the Companies Acts 1931-2004, the Limited Liability Companies Act 1996 and the Companies Act 1982, as amended from time to time.</b>
Controller	<b>A person who, alone or with any <i>associate</i> or <i>associates</i>, is entitled to exercise or control 15% or more of the rights to vote on all or substantially all matters at general meetings of a body corporate, or of another body corporate of which it is a subsidiary undertaking.</b>
corporate practice	<b>A body corporate, excluding a limited liability partnership (in cases where such a partnership is a body corporate).</b>
Council	<b>The Council of the <i>Institute</i> under Clause 2 of the Supplemental Royal Charter of 21 December 1948.</b>
Crown Dependencies	<b>Guernsey, Jersey and the Isle of Man.</b>
director	<b>Any person occupying the position of director (called by whatever name) in a <i>corporate practice</i>. Also any person under whose directions or instructions the directors of the <i>corporate practice</i> are used to acting.</b>
Disciplinary Committee	<b>The committee of the <i>ICAEW</i> with responsibility for disciplining members, firms and others.</b>
employee	<b>Anyone who carries out <i>audit work</i> for a <i>recognised auditor</i>, including a sub-contractor or a consultant.</b>  A sub-contractor or consultant cannot become a responsible individual.

ethical standards	<b>The basic principles and essential procedures (shown in bold type) in the Ethical Standards issued by the <i>Financial Reporting Council</i> which are to be construed and applied having regard to the explanatory text and other material in those standards, and where references in those standards to a ‘public interest entity’ should be read to include a <i>market traded company</i>.</b>
Financial Reporting Council (FRC)	<b>The Financial Reporting Council Limited, a company limited by guarantee incorporated in England and Wales, number 2486368 and any other body which takes over its functions under the <i>recognised auditor sanctions procedure</i>.</b>
firm	<b>a) an individual who engages in the profession of accountancy as a sole practitioner;</b> <b>b) a partnership which engages in the profession of accountancy;</b> <b>c) a limited liability partnership which engages in the profession of accountancy; or</b> <b>d) a <i>corporate practice</i> which engages in the profession of accountancy.</b>
group	<b>A <i>corporate practice</i>, any parent or subsidiary undertakings and any parent or subsidiary undertakings of any of them.</b>
Institute	<b>the Institute of Chartered Accountants in England and Wales.</b>
Investigation Committee	<b>The committee of the <i>Institute</i> with responsibility for considering complaints against members, firms and others.</b>
management board	<b>Any committee, board or other management body that is responsible for setting and directing the implementation of the <i>firm’s</i> policies.</b>
market traded company	<b>A company defined as such in the <i>Companies Law</i>.</b>
monitoring unit	<b>The <i>Institute</i> or any other body approved by the relevant <i>registrar</i> to undertake monitoring of compliance with the <i>rules</i>.</b>  The Financial Reporting Council (Audit Quality Review team) is an approved monitoring unit.
oversight body	<b>A body which pursuant to the <i>Companies Law</i> is responsible for overseeing the monitoring work of a <i>monitoring unit</i>.</b>
PII Regulations	<b>The Professional Indemnity Insurance Regulations of the <i>Institute</i>.</b>
practice notes	<b>Practice notes and bulletins issued by, or with the authority of, the <i>Financial Reporting Council</i>.</b>  These give guidance on how auditing standards can be applied and on new or emerging issues.

principal	<p>An individual in sole practice, (where the <i>firm</i> is a sole practice), a person who is a partner (including both salaried and equity partners) (where the <i>firm</i> is a partnership), a member of a limited liability partnership (where the <i>firm</i> is a limited liability partnership) a <i>director</i> (where the <i>firm</i> is a body corporate) or any individual who is held out as being a company director, partner or member.</p> <p>Corporate practices or limited liability partnerships may be principals, where the Companies Law allows.</p>
quality control standards	<p><b>The basic principles and essential procedures (shown in bold type) in the International Standards on Quality Control (UK) 1 which are to be construed and applied having regard to the explanatory text and other material in those standards, as issued by the <i>Financial Reporting Council</i>.</b></p> <p>Notwithstanding that the <i>rules</i> require a <i>recognised auditor</i> to comply with the International Standards on Quality Control (UK) 1, it is acceptable for such compliance to be achieved by a <i>recognised auditor</i> complying with the International Standards on Quality Control (issued by the International Auditing and Assurance Standards Board). The definition of <i>quality control standards</i> shall be construed accordingly.</p>
recognised auditor	<b>A <i>firm</i> whose name is entered on the <i>register</i>.</b>
recognised auditor sanctions procedure	<b>The rules and practices of the <i>Financial Reporting Council</i> (the Crown Dependencies' Recognised Auditor Regulatory Sanctions Procedure) which provide for a <i>sanction</i> determined by it arising from independent monitoring of <i>market traded company</i> audits to be treated as if it were a <i>sanction</i> which the <i>Institute</i> had itself determined.</b>
Registration Committee	<b>The committee of the <i>Institute</i> with responsibility for discharging the functions set out in Chapter 6 or any sub-committee of that committee.</b>
register	<p><b>In Jersey - the register of recognized auditors maintained by the Jersey Financial Services Commission pursuant to the Companies (Jersey) Law 1991;</b></p> <p><b>In Guernsey - the register of recognised auditors maintained by the Guernsey Registrar of Companies pursuant to the Companies (Guernsey) Law, 2008;</b></p> <p><b>In the Isle of Man - the register of recognised auditors maintained by Isle of Man Financial Services Authority pursuant to the Companies Act 1982 of the Isle of Man.</b></p>
registrar	<p><b>In respect of a firm entered on:</b></p> <ul style="list-style-type: none"> <li>- the register of recognized auditors in Jersey, the Jersey Financial Services Commission;</li> <li>- the register of recognised auditors in Guernsey, the Guernsey Registrar of Companies;</li> </ul>

	- the register of recognised auditors in the Isle of Man, the Isle of Man Financial Services Authority.
regulated market	Has the same meaning as in Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments (see Article 4.1(14) of the Directive).
rules	These rules as modified or amended.
regulatory penalty	An amount imposed with the consent of a <i>recognised auditor</i> as a penalty for breaches of the <i>rules</i> which the <i>recognised auditor</i> agrees have been committed.
responsible individual	An individual who has been designated under <i>rule 4.01</i> to be responsible for examining and reporting on the accounts of a company
Review Committee	Any <i>Institute</i> committee with responsibility for reviewing decisions made by the <i>Registration Committee</i> as specified in the <i>rules</i> .
sanction	Any regulatory action including the imposition of conditions or restrictions, a recommendation that the relevant <i>registrar</i> suspends or withdraws a <i>recognised auditor's</i> registration, and imposition of a regulatory penalty.

## **Interpretation**

In the rules words importing the singular number include the plural number and vice versa. Words importing the masculine gender include the feminine. Headings do not affect the interpretation of the rules. The rules will be governed by, and interpreted according to, the law of England and Wales.

Unless the context indicates otherwise, where reference in the *rules* is made to the defined terms, “*Companies Law*”, “*register*” or “*registrar*”, it should be construed as a reference to the *Companies Law*, *register* or *registrar* in the Crown Dependency in which the *market traded company* to be audited (or is being audited) is incorporated.

Any references to legislation, rules, bye-laws, rules, standards or other documents, will apply to any re-enactment, re-issue or amendment.

## CHAPTER 2 - APPOINTMENT AND CONTINUING OBLIGATIONS

This chapter sets out the audit appointment criteria and continuing obligations applicable to recognised auditors.

### Appointment

**2.01** No *firm* may accept an *audit* appointment in relation to a *market traded company* (or continue an appointment as auditor of a company if the *firm* becomes aware that the company has become a *market traded company*) unless:

(a) its name is entered on the *register*.

(b) the *firm* has professional indemnity insurance or other appropriate arrangements as required by the *PII Regulations* (a reference to “registered auditor” in the *PII Regulations* shall be deemed to include a reference to a *recognised auditor*);

(c) the *firm* has appointed an *audit compliance principal* (a sole practitioner will be deemed to be the *audit compliance principal*);

(d) each *responsible individual* has been designated in accordance with *rule 4.01*; and

(e) if the *firm* is a sole practitioner, the sole practitioner is a *responsible individual* and the *audit compliance principal*.

**2.02** [NOT RELEVANT]

**2.03** [NOT RELEVANT]

**2.03A** [NOT RELEVANT]

### Application for registration

**2.04** [NOT RELEVANT]

**2.05** [NOT RELEVANT]

### Continuing obligations

**2.06** A *recognised auditor* must continue to meet the requirements of the *rules*.

**2.07** Subject to *rules 2.17* to *2.20*, a *recognised auditor* must not continue as an auditor of a *market traded company* if it ceases to meet the requirements of *rule 2.01*.

**2.08** A *recognised auditor* must cooperate with the *Institute*, its staff, committees, a *monitoring unit*, or the *registrar*.

**2.09** A *recognised auditor* or former *recognised auditor* on whom the *Institute* serves a notice requesting information or notice of a visit under *rule 2.23* or *6.02k* must comply with such notice within such period as the *Institute* may allow.

When the Institute serves a notice under the above rule, the notice will specify by when the firm must deal with the matters in the notice. The Institute will always try to give reasonable time for the firm to respond but in some cases it may be necessary to set a short time for the firm to respond.

**2.09.1 If a *recognised auditor*:**

- a** is appointed auditor of a *market traded company* (or becomes aware that an existing *audit client* has become a *market traded company*);
- b** ceases to be appointed as auditor of a *market traded company* (or becomes aware that an existing *audit client* is no longer a *market traded company*); or
- c** becomes aware that an existing *audit client* that is a *market traded company* has its securities admitted to trade on an additional *regulated market* or has its securities removed from admittance on a *regulated market*;

then the *recognised auditor* must inform the *Institute* in writing as soon as practicable, but not later than 21 *business days* after the event, of the name of the *audit client* and the name of the *regulated market*.

**2.09A** A *recognised auditor* must comply with the monitoring arrangements of a *monitoring unit*.

**2.10** [NOT RELEVANT]

**2.10A** A *recognised auditor* must provide such returns, statements or other information as considered necessary and in a form decided by the *Registration Committee*.

**Changes in circumstances**

**2.11** A *recognised auditor* must inform the *Institute* in writing as soon as practicable, but not later than ten business days after the event:

- a** of any matter, whether relating to the *firm* or to any of its *principals* or *employees*, which could mean that the *firm* is no longer fit and proper to be a *recognised auditor*;
- b** if the *firm* is no longer complying with the *PII Regulations*;
- c** of any other matter which might affect a *firm's* eligibility to be registered or its ability to conduct *audit work*;
- d** [NOT RELEVANT]
- e** [NOT RELEVANT]
- f** [NOT RELEVANT]

g [NOT RELEVANT]

h [NOT RELEVANT]

i [NOT RELEVANT]

2.12 [NOT RELEVANT]

### Fees

2.13 A *recognised auditor* must pay such fees (to include any costs that the *Institute* is required or has agreed to pay to any *monitoring unit* or to any other person or body exercising a regulatory or supervisory role in relation to it) as the *Institute* determines, at the times and at the rates set by it.

2.14 [NOT RELEVANT]

2.15 The *Institute* may charge a *recognised auditor* to which its representatives have made a second or subsequent visit as a result of an earlier visit. The *Registration Committee* will decide how much the fee will be.

The Committee may decide that, following a monitoring visit to a firm, it wishes to return to check that the firm is making the necessary improvements in its audit work. A charge may be made for any such visits, although an estimate would normally be given.

2.16 A *recognised auditor* must pay any fees under *rule 2.13* or *rule 2.15*, within 60 days of the invoice date. The *Institute* will advise the *registrar* of any breach of this *rule*.

### Dispensation

2.17 If a *recognised auditor* ceases to meet the requirements of *rule 2.01*, or if it considers that it is impossible or impractical to comply with any other *rule*, it must notify the *Registration Committee* in writing. The notification must be within ten *business days* of the situation arising and must say what has happened and the action which the *recognised auditor* proposes to take.

2.18 The *Registration Committee* will review the information provided under *rule 2.17*. If the committee considers that the *recognised auditor* is taking all practical steps and that these will remedy the position, it may, with the agreement of the *registrar*, grant the *recognised auditor* a dispensation from the requirement to comply with any *rule*.

2.19 [NOT RELEVANT]

2.20 The *Registration Committee* will not grant a dispensation under *rule 2.18* unless the *recognised auditor* can satisfy the committee that its continued registration on the *register* during the dispensation period would not adversely affect an *audit client* or any other person.



## **Cessation of registration**

**2.21 [NOT RELEVANT]**

**2.22 [NOT RELEVANT]**

**2.23 If a *firm* is no longer a *recognised auditor*:**

- a it must still respond to enquiries (made in writing or by visiting a *firm's* office or offices) from the *Registration Committee*, a *registrar*, or a *monitoring unit* in connection with any circumstance that relates to the *rules* during the time the *firm* was registered;**
- b it must still respond to enquiries made by another *recognised auditor* in accordance with *rule 3.09*;**
- c disciplinary action (including the imposition of a regulatory penalty) may still be taken for:
  - 1) any failure to comply with the *rules* during the time it was registered;**
  - 2) any failure to comply with any *rule* continuing to have effect notwithstanding that registration has ceased;**
  - 3) any failure to keep confidential any information received in the course of *audit work*.****

The effect of rule 2.23 is that a firm cannot escape disciplinary action by de-registering. There is a continuing obligation to deal with requests for access to audit working papers under rule 3.09.

**2.24 The *Institute's* right to recover any unpaid fees or other amounts due from a *firm* under the *rules* does not end when a *firm* is no longer registered.**

De-registering does not remove the firm's obligation to pay outstanding fees.

## CHAPTER 3 - CONDUCT OF AUDIT WORK

This chapter describes how recognised auditors must conduct their audit work in relation to market traded companies.

Recognised auditors must:

- be independent;
- carry out their work with integrity;
- be fit and proper;
- keep to technical standards;
- be competent and continue to be competent; and
- be able to meet claims against them that may arise from audit work.

The Institute has adopted the auditing, quality control and ethical standards of the Financial Reporting Council. The standards adopted are:

- the International Standards on Auditing (UK), which deal with the conduct of individual audits;
- the International Standard on Quality Control (UK) 1, which deals with the overall system of quality control established by the recognised auditor; and
- the ethical standards, which set out the ethical obligations of recognised auditors and their personnel with respect to auditor independence and objectivity.

Firms must make sure that they continue to meet the requirements of the rules. For most firms this means having procedures for doing audit work, and checks to make sure that the procedures are followed. The procedures and checks apply to individual audits (for example that audits are conducted according to auditing standards) and also to a firm's audit practice (for example that principals and employees maintain their competence to undertake audit work).

Firms of different sizes and with different types of client will adopt different procedures to comply with the rules. However, all firms will be aiming to provide a high-quality and cost-effective service which complies with the rules.

Firms usually have professional indemnity insurance to meet claims against them. However, another aspect of this is the use of appropriate procedures, including review procedures, to reduce the possibility of a matter occurring that could give rise to a claim.

The following rules, and associated guidance, deal with matters that relate to firms' audit work.

### **Independence and Integrity**

- 3.01 A recognised auditor must not accept an appointment or continue as an auditor if the firm has any interest likely to conflict with the proper conduct of the audit.**
- 3.02 A recognised auditor must act in accordance with the fundamental principles set out in the Code of Ethics issued by Council and the ethical standards.**
- 3.03 A recognised auditor must consider its independence and ability to perform the audit properly and record this before it accepts appointment or reappointment as auditor.**

**3.04 A recognised auditor must not accept or continue an *audit* appointment of a *market traded company* where:**

- a** there exists between the *recognised auditor* and the company a relationship where the *Companies Law* prohibits the *recognised auditor* auditing that company;
- b** the company is a shareholder in the *recognised auditor*;
- c** the company can be influenced by a shareholder in the *recognised auditor*;
- d** the company is a *principal* in the *recognised auditor*;
- e** the company, being neither a shareholder or *principal* in the *recognised auditor* has the ability to influence the affairs of the *recognised auditor*;
- f** the *recognised auditor* is a shareholder in the company;
- g** the *recognised auditor* is a *principal* in the company; or
- h** the *recognised auditor* is in a position to exercise influence over the company.

The above rule prevents a firm auditing any market traded company where that company has some form of shareholder interest in the firm, is a principal in the firm, or can exert influence over the recognised auditor. It also prevents a firm auditing a market traded company where the firm is either a principal or shareholder in the client, or can exert influence over the company.

The extent of influence is not defined but firms should consider whether an informed third party would consider that influence could exist, even if not being exercised. The forms that such influence can take do not include any influence that arises as a result of the auditor's normal relationship with the entity.

Recognised auditors are also reminded that the ethical standards and in particular ISQC1 includes material about situations where a firm should consider accepting or continuing an audit appointment.

The main considerations which should be followed are contained in the Code of Ethics. This is included in the Members Handbook of the Institute. This in turn requires firms to follow the Financial Reporting Council's ethical standards. Firms should refer to these documents for a fuller discussion of the matters that can threaten a recognised auditor's independence.

Contracts of employment (with employees, sub-contactors or consultants) may include the requirement to comply with rule 3.02. If such contracts are not used, for example in the case of principals, a separate statement or appropriate clause in a partnership agreement is advisable.

As well as material on independence, other relevant statements (for example on conflicts of interest) are contained in the Members' Handbook of the Institute.

**3.05 A recognised auditor must always conduct *audit work* properly and with integrity.**

Integrity means more than just honesty. It includes fair dealing, truthfulness and the desire to follow and maintain high standards of professional practice.

**3.06 A recognised auditor must make arrangements so that each *principal* and anyone the firm employs to do *audit work* or permits to be involved in its *audit work* is, and continues to be, a fit and proper person.**

The guidance in chapter 1 suggests how to assess the fit and proper status of principals and employees, as required by rule 3.06. There are also sample checklists that firms may find useful in making their assessments. This rule also applies to sub-contractors and consultants who may assist with audit work. They must satisfy the same requirements as anyone employed directly by the recognised auditor.

It is recommended that every principal, employee, sub-contractor and consultant should confirm their fit and proper status every year. This only applies to those, including principals, who deal with audit work. But it may be easier for firms to apply these procedures to all employees, instead of making distinctions that may be a little artificial. In any case individuals must be encouraged to notify the audit compliance principal of any event that affects their fit and proper status as soon as it occurs.

When a recognised auditor sub-contracts work to another firm or an individual, whether a recognised auditor or not, there should be a formal engagement letter or contract. This should make clear who is responsible for the different parts of the accountancy and audit work. A sub-contractor should be treated as an employee for the purposes of the work.

Some of the auditing standards deal with procedures for auditors who use the work of others in connection with the audit. These are:

- ISA 610 'Using the work of internal auditors';
- ISA 600 'Special considerations – audits of group financial statements (including the work of component auditors)'; and
- ISA 620 'Using the work of an auditor's expert'.

**3.07 A recognised auditor must make arrangements to prevent anyone who is not a *responsible individual* in the firm from having any influence which would be likely to affect the independence or integrity of the *audit*.**

Rule 3.07 is particularly important for mixed practices or associated firms whose principals are not responsible individuals, whatever their qualification. The rule does not prevent such people from taking part in audit work. However, responsibility for the overall direction of the audit, its supervision, performance and reaching a conclusion that sufficient and appropriate audit evidence has been obtained prior to signing the audit report must always be in the hands of responsible individuals.

Where a recognised auditor uses, for the purposes of its own audit work (not being the audit of a foreign subsidiary), individuals resident in another country, it should undertake and document appropriate steps to establish, within the confines of the law of that other country, that the individuals are fit and proper, independent and competent to undertake audit work.

## **Technical standards**

Each audit must be conducted in accordance with the auditing standards and the legislation under which the auditor is reporting.

**3.08 A recognised auditor must comply with the requirements of the *Companies Law* and other relevant legislation.**

The requirements include:

- appointment;
- ceasing to hold an appointment and making appropriate resignation statements; and
- the responsibilities of the auditor to provide an opinion on whether financial statements have been properly prepared in accordance with the legislation.

Other relevant legislation would, for example, include laws regulating banks, insurance companies, other financial service businesses and so on.

**3.09 When a *recognised auditor* (the ‘predecessor’) ceases to hold an audit appointment and another *recognised auditor* (the ‘successor’) is appointed the predecessor must, if requested in *writing* by the successor, allow the successor access to all relevant information held by the predecessor in respect of its *audit work*. If relevant information is to be sought by the successor, it should be sought and provided in accordance with the following guidance. Any information obtained by the successor is for the purposes of its *audit* and must not be disclosed to a third party unless the successor is required to do so by a legal or professional obligation.**

The purpose of the rule is to assist in maintaining the effectiveness (including cost effectiveness) and the efficiency of the audit process in the context of a change of auditor. The rule is intended to reduce the (actual or perceived) risk of changing auditors.

This guidance is separate from and additional to the Institute’s Code of Ethics which sets out procedures to be followed before accepting a professional appointment.

Timing

A request for relevant information may be made by a successor once the successor has been formally appointed to the audit client. In all cases the provision of information should be on a timely basis.

Procedure

Before making a request for relevant information the successor should as part of its planning consider the need to make a request to the predecessor under the rule, and the extent of that request. This will involve judgement by the successor in each case, so as to ensure that a necessary request is made and an unnecessary request is not. It is also important to assess what information will be relevant in each case and what will not.

It does not follow that a successor is required or expected to request information in every case, or to request extensive information in a case in which only limited information is necessary. The successor’s consideration will include consideration of what work it would do with any information provided to it pursuant to a request. There are specific references to reviewing the predecessor’s audit work in ISA 510 (opening balances), ISA 710 (comparatives) and ISA 300 (planning). Accordingly, information is likely to be necessary in particular for such purposes.

The provision of information under this rule will be achieved more efficiently where the successor auditor is as specific as possible as to the nature of the information being sought.

The successor should therefore, wherever possible, avoid a request framed simply as a request for “all relevant information held by the predecessor and concerning the audited entity” or “all relevant information held by the predecessor in relation to the office of auditor”. Thus the successor should strive to identify the information required, or the type of information required, as precisely as possible.

For example, where relevant information is requested by the successor, the information will normally be that contained in the working papers produced by the predecessor, and the appropriate request may therefore be for some or all of those working papers. In some audits there will be Institute or FRC guidance indicating the working papers expected for such an audit. For example in the case of a financial statement audit, ISAs will indicate the audit working papers to be prepared. In other cases, where there is no guidance, the predecessor will have determined the working papers to be prepared.

Where the information related to audit work is requested by the successor but is not filed on the current audit file but, for example, on a ‘permanent’ or ‘systems’ file, or there is a reference to a prior audit file, access should be provided by the predecessor to this information.

The predecessor should be prepared to assist the successor by providing oral or written explanations on a timely basis to assist the latter’s understanding of the audit working papers.

In addition to providing access to all relevant information held about its audit work, the predecessor must provide any reports made to the market traded company’s audit committee and any reports made to competent authorities who exercise a supervisory role over the market traded company.

#### Period

Normally the period for which relevant information is requested would be in respect of any audit report relating to a period falling between the beginning of the last financial statements on which the predecessor reported and the date of cessation of the predecessor’s audit appointment. The request would include any subsequent review conducted by the predecessor in accordance with guidance published by the FRC in relation to published interim reports.

A successor may consider that it needs to have information in addition to that within the period mentioned above. In the normal case, in the interests of cost and efficiency, the successor should first review the information already provided. If after that review a judgment is made that additional information is needed, the additional information sought should be described in writing, as precisely as possible. The successor should be prepared to provide reasons which demonstrate that the additional information is “relevant” information and therefore within the rule. Here as elsewhere the successor should be prepared to confirm that the information is needed to aid its audit work for the audit client and not for some other purpose.

#### Other points

The request for information may be made of the immediate predecessor only.

Because (as indicated above) it is no part of the purpose or object of the rule to involve one auditor in liability for another’s audit, it would be usual for the basis on which the information is to be provided to be documented in writing by an exchange of letters between the two recognised auditors, copied to the audited entity. Guidance on suitable letters is available on the Institute’s website as part of a technical release.

There is no obligation to allow the copying of working papers but it would be usual to allow copying of extracts of the books and records of the audit client that are contained in the audit working papers. Generally speaking, where access to relevant information is necessary, the practical arrangements to allow that access to be provided in a cost effective and efficient way should be discussed and agreed between the successor and the predecessor.

A request for information under the rule should not be made other than in connection with the successor's audit. The successor should refuse to accept an additional engagement, such as to act as an expert witness or to review the quality of the predecessor's audit work, where the engagement would involve the use of the information obtained by it under the rule. In any event, the successor should not comment on the quality of the predecessor's audit work unless required to do so by a legal or professional obligation.

The reference in the rule to the information not being disclosed to a third party includes to the audit client. This does not prevent the successor discussing the information with the client where to do so is a necessary part of its audit work. Nor does it prevent the provision of this information to any third party if that is required of the successor by a legal or professional obligation.

**3.10 A recognised auditor must comply with the auditing standards and the quality control standards.**

Guidance included with auditing standards and practice notes gives assistance on how to apply the standards.

A recognised auditor must comply with the rules, the auditing standards and quality control standards as applied in accordance with the explanatory and other material published therewith.

**3.11 A recognised auditor must keep all audit working papers which auditing standards require for an audit for a period of at least six years. The period starts with the end of the accounting period to which the papers relate.**

ISA 230 (audit documentation) details the content of audit working papers. Other ISAs (for example ISA 300 (planning an audit of financial statements)) detail other documentation that needs to be created during the course of an audit. All these papers must be kept for a period of six years starting with the end of the accounting period to which the papers relate.

The audit working papers and other records do not have to be on paper but could instead be held on microfilm or on computers. Whatever method of storage is used, the auditor must also keep a mechanism for gaining access to those papers.

Firms should have a procedure to make a final decision, before any papers are destroyed, that the files are unlikely to be needed again. In cases of doubt they should be kept. The decision could be to destroy every file, or to make some exceptions. Firms should also bear in mind that some papers in the audit file may serve another purpose, for example tax. Care is needed that these are not destroyed when a longer retention period may apply. A firm should keep appropriate records of what files it has destroyed.

**3.12 A recognised auditor must make arrangements so that if any of its audit work is carried out by another firm, then:**

- a all the audit working papers created by that *firm* are returned to the *recognised auditor*; or
- b the other *firm* agrees to keep those papers as required by *rule 3.11* and allows the *recognised auditor* unrestricted access to the papers for whatever reason.

Recognised auditors will sometimes 'sub-contract' some of their audit work to another firm. This could be because the audit client is in a remote location and it is more cost-effective to engage a local firm to do any necessary work and it is that relationship to which this rule is directed.

If this happens, then, under rule 3.12, all the audit working papers created by the other firm have to be returned to the recognised auditor for retention in accordance with rule 3.11. Alternatively, the other firm may keep the papers. In this case the recognised auditor must make sure that the other firm will keep the papers for as long as the auditor would. Also the recognised auditor must have the right to have access to those papers at any time, and retrieve them if necessary. As with papers held directly by the recognised auditor, any decision to destroy the papers should be made by the recognised auditor and not the other firm.

If a recognised auditor considers that, despite any agreements with the other firm, gaining access to the papers may prove difficult, the recognised auditor should consider changing the arrangements. If this is not possible, the recognised auditor should document the steps taken to obtain access to the audit working papers and the reasons why it cannot and any evidence of those steps or reasons. The recognised auditor should also document how it has satisfied itself as to the matters dealt with in those papers and any implications for the audit opinion. The recognised auditor should use the principles in ISA 230 (audit documentation) and ISA 500 (audit evidence) when considering such matters.

Whatever arrangements are made between two firms, they should be recorded in a suitable letter of engagement or contract. If the other firm is itself not subject to the rules it may be appropriate to include within the letter the full text of the above rules. The letter may also cover such matters as the scope of work to be undertaken by the other firm.

This rule does not require the auditor of a holding company to seek and maintain access to the working papers of the auditor of a subsidiary company (but see rule 3.13).

- 3.13 In the case of a group audit where part of the group is audited by a *firm* from outside the Crown Dependency in which the *recognised auditor* is registered, a *recognised auditor* should, if requested by a *monitoring unit* or an *oversight body*, request from that *firm* all the audit working papers necessary for a review of that *firm's* audit work.**

If, after taking all reasonable steps, a recognised auditor cannot obtain copies or access, it should document the steps taken and the reasons why it could not obtain copies or access and any evidence of those steps and reasons.

- 3.14 If requested by an overseas competent authority a *recognised auditor* must provide that body with a copy of its audit working papers in relation to one or more specified *market traded companies* that it audits as soon as practicable, provided:**

- a there is an *agreement* between that competent authority and the *registrar*;



- b** the competent authority has requested the audit working papers for the purposes of an investigation;
- c** the competent authority has given the *registrar* notice of its request;
- d** no legal proceedings have been brought in relation to the recognised auditor or the *audit* to which the working papers relate; and
- e** the *registrar* has raised no objection to the transfer.

For the purposes of this regulation:

- a 'competent authority' is a body that is designated in the law of the relevant jurisdiction as having responsibility for the regulation or oversight of auditors.
- 'transfer' means the physical or electronic transfer of audit working papers (or a copy) or allowing access to such papers;

Before any papers are transferred the recognised auditor should check with the registrar that it:

- has an agreement with the other competent authority to allow for the transfer of papers;
- has received a copy of the request; and
- has raised no objection to the transfer.

### **3.15 [NOT RELEVANT]**

#### **Audit report**

### **3.16 Save as otherwise authorised by the *Companies Law* in force at the time of signing the *audit report*, any *audit report* must:**

- a** state the name of the *responsible individual* who was in charge of the *audit* and be signed by this person in his own name;
- b** [NOT RELEVANT]
- c** state the name of the *firm* as it appears in the *register*.

### **3.16A [NOT RELEVANT]**

## Maintaining competence

### **3.17 A recognised auditor must make arrangements so that all *principals* and *employees* doing *audit work* are, and continue to be, competent to carry out the *audits* for which they are responsible or employed.**

The Institute has issued guidance on how individuals may maintain their competence. This is on the ICAEW's website at [icaew.com/cpd](http://icaew.com/cpd).

Responsible individuals who are not Institute members should follow the guidance on continuing professional development of the professional body of which they are a member.

### **3.18 A recognised auditor must maintain an appropriate level of competence in the conduct of *audits*.**

Under rule 3.18 a firm must be able to ensure its competence in the future. Although a firm's ability to audit rests with its principals and employees, these individuals change. It is only by using audit manuals, programmes, checklists, procedures and so on that a firm has a body of knowledge beyond that of the individual principals and employees. These provide the link between the people currently in the firm and those who will join in the future.

The amount of formal documents and procedures will vary according to the nature of the firm's clients. Their use is likely to vary even between different clients of the same firm. Even the smallest firm is likely to need some documentation such as audit programmes and checklists. As a firm grows in size, it will probably develop procedures to help employees and principals use the audit programmes and checklists in order to carry out audit work and comply with the rules.

Any documentation used by a firm in its audit work must be kept up to date if a firm is to retain its audit competence. Smaller firms might join some form of updating service to help them with this.

### **3.19 A recognised auditor must make sure all *principals* and *employees* involved in *audit work* are aware of and comply with the *rules*, the *Companies Law*, any relevant subordinate legislation issued under the *Companies Law* and any procedures established by the *firm*.**

It is important that those involved in auditing should understand the:

- requirements imposed on the firm by statute and rules;
- legal and other requirements relating to financial statements;
- procedures the firm depends on to ensure it does audit work competently; and
- auditing and ethical standards.

A firm needs to communicate its requirements and procedures effectively if everyone is to understand them. This is especially important since principals, employees, laws and rules change. Training can achieve much of this. The review of delegated work required by ISA 220, 'Quality control for audits of historical financial information', and the checks performed as part of the annual compliance review, can then reveal successful communication - or the lack of it.

## **Monitoring**

### **3.20 A recognised auditor must monitor, at least once a year, how effectively it is complying with the rules and take action to deal with any issues found and communicate any changes in procedures to principals and employees on a prompt basis.**

Since the rules require recognised auditors to comply with the auditing, ethical and quality control standards, then the monitoring required by this rule should also include how the firm is complying with those standards.

An annual review can focus simply on the important point of whether audit work is being carried out in accordance with the rules and ISAs and that the firm's system of quality control complies with the rules and ISQC1. However, a thorough review of a firm's work can bring benefits and assurance far in excess of the above requirement.

A thorough review could identify areas in which changes could be made to enhance audit quality, situations where clients need extra services, or where excessive audit work can be reduced. Both benefit the firm and provide assurance that the firm is not needlessly exposed to risk through poor work, whatever its cause.

The annual compliance review in its simplest form is in two parts. The first part covers a firm's obligations under the rules such as:

- independence and integrity;
- fit and proper status;
- competence;
- appointment and re-appointment;
- professional indemnity insurance; and
- continuing eligibility.

and under ISQC1 such as:

- leadership responsibilities;
- consultation arrangements;
- human resources; and
- complaints.

The second part of an annual compliance review deals with cold file reviews. How many files should be reviewed will depend on the number of audits of market traded companies that a recognised auditor undertakes. Each audit should be reviewed at least once over a three year cycle. Where this would lead to repeated reviews of the same audit (and which were not justified for other reasons) it would be appropriate to review other audit work of the relevant responsible individual.

Sole practitioners, firms with only one responsible individual and other small firms should note that ISQC1 does not permit the responsible individual or the engagement quality control reviewer for a particular audit to undertake a cold file review on that audit. It may be that there is another individual in the firm who, although not a responsible individual, is very experienced in current auditing requirements. Assuming that this individual did not take part in the audit, the firm may decide this individual would be a suitable person to undertake the review. If this is not possible, then the firm should use an external reviewer at least once every three years.

Whatever approach a firm adopts for cold file reviews, it should be ready to justify that approach when requested by the Registration Committee or a monitoring unit.

The compliance review, and cold file reviews carried out as part of that review, are likely to vary in formality according to the size of the firm. However, every firm should be able to provide evidence of its review and, where appropriate, any action taken.

All responsible individuals should be given the results of the monitoring exercise at the earliest opportunity. If improvements are needed, any necessary changes should be made as soon as possible.

There is no need for the firm to conduct the review itself. Some firms may find it more practical and cost-effective to use a service provided by a professional body, or a third party, such as another recognised auditor or some other organisation. In choosing a reviewer, it is important that the firm is satisfied that the reviewer has sufficient experience to undertake the review.

Sole practitioners may also benefit from this exercise if it is carried out by another recognised auditor. This could highlight practical ways for a firm to improve procedures and to deliver a better service to clients. Practitioners may also benefit from reviewing another practice.

Using an external reviewer does not reduce the firm's own responsibility for the review or for ensuring that any necessary action is taken

There is further guidance in part 2, chapter 2 on how recognised auditors can monitor their own compliance with the rules.

**3.21 Each *recognised auditor* (other than a sole practice) must appoint an *audit compliance principal*. A sole practitioner will be the *audit compliance principal*.**

## CHAPTER 4 - RESPONSIBLE INDIVIDUALS

Responsible individuals are those individuals who are responsible for examining and reporting on the accounts of a company.

In all firms (including sole practices) the audit compliance principal can designate appropriately qualified principals or employees as responsible individuals as set out in the following rules.

### Designation of responsible individual

**4.01 The *audit compliance principal* may designate as a *responsible individual* any of the *recognised auditor's principals or employees* who:**

- a are permitted under the *Companies Law* to examine and report on the accounts of a company;**
- b has confirmed in writing to the *registrar* and the *firm* that he/she agrees to abide by the *rules*;**
- c is competent to conduct *audit work*; and**
- d is allowed to sign *audit reports* in their name on behalf of the *firm*.**

To examine and report on the accounts of a company the Companies Law requires the individual to be a member of a professional body recognised in the Companies Law and hold a current practising certificate.

Chapter 3 in Part 2 provides guidance for audit compliance principals when assessing the competence of individuals to be designated as responsible individuals.

**4.02 [NOT RELEVANT]**

**4.03 Consultants and sub-contractors cannot be designated as *responsible individuals*.**

**4.04 Only *responsible individuals* can be responsible for an *audit* and sign an *audit report*.**

Firms which designate employees as responsible individuals must have procedures on how the employees exercise the firm's authority.

**4.05 [NOT RELEVANT]**

**4.06 A *responsible individual* may not accept appointment as a *director* or other officer of a *market traded company* if, at any time during the two years preceding the date of the proposed appointment, the *responsible individual* acted in the capacity of *responsible individual* for that *market traded company*, or for a material subsidiary thereof.**

The above rule is to prevent a responsible individual joining such an audit client until a two year period has elapsed since the individual last undertook any audit work in relation to the client. A firm may find it useful to remind any responsible individual that leaves the firm of this rule.

**4.07** The disciplinary arrangements of the *Institute* will apply to breaches of the *rules* by a *responsible individual*. Where the *responsible individual* is not a member of the *Institute* the disciplinary arrangements will apply as though the *responsible individual* were a member.

#### **Cessation of responsible individual status**

**4.08** [NOT RELEVANT]

**4.09** If an individual is no longer a *responsible individual* disciplinary action (including the imposition of a regulatory penalty) may still be taken for any failure to keep confidential any information received in the course of *audit work* (as required by law) and for any failure to comply with *rule 4.06*.

## CHAPTER 5 - AUDIT AFFILIATES

5.01 [NOT RELEVANT]

5.02 [NOT RELEVANT]

5.03 [NOT RELEVANT]

5.04 [NOT RELEVANT]

5.05 [NOT RELEVANT]

5.06 [NOT RELEVANT]

5.07 [NOT RELEVANT]

5.08 [NOT RELEVANT]

5.09 [NOT RELEVANT]

5.10 [NOT RELEVANT]

5.11 [NOT RELEVANT]

5.12 [NOT RELEVANT]

5.13 [NOT RELEVANT]

5.14 [NOT RELEVANT]

5.15 [NOT RELEVANT]

5.16 [NOT RELEVANT]

## CHAPTER 6 - THE COMMITTEES

This chapter describes the various committees involved in the regulatory process and their powers. Some, but not all, of the powers may be delegated by the Registration Committee to either sub-committees or the staff.

A firm generally has the right to seek a review of a decision. Details are in chapter 8.

### Registration Committee

#### 6.01 [NOT RELEVANT]

#### 6.02 Subject to the *recognised auditor sanctions procedure*, the *Registration Committee* is responsible for:

- a [NOT RELEVANT]
- b [NOT RELEVANT]
- c [NOT RELEVANT]
- d recommending to the *registrar* the withdrawal of a *recognised auditor's* registration;
- e recommending to the *registrar* the suspension of a *recognised auditor's* registration;
- f imposing restrictions or conditions it considers appropriate on how a *recognised auditor* carries out *audit work* (see chapter 7);
- g proposing a *regulatory penalty* it considers appropriate to a *recognised auditor* (see chapter 9);
- h granting or refusing dispensation from the requirements of *rule 2.01*;
- i reviewing the returns and reports (see *rule 6.06*) made under the *rules*, and investigating failure to make returns or reports;
- j [NOT RELEVANT]
- k making appropriate enquiries to confirm that a *recognised auditor* or *responsible individual* is complying with the *rules* (by writing, visiting a *firm's* office or offices, using a periodic return, or in any other way);
- l publishing its orders or decisions if it considers this appropriate; and
- m supplying information to the *registrar*, or a *monitoring unit* in connection with their duties under the *Companies Law*;



- n [NOT RELEVANT]
- o [NOT RELEVANT]; and
- p implementing decisions in accordance with *sanctions* issued against a *firm* or an individual determined under the *recognised auditor sanctions procedure*.

Rule 6.02 sets out the powers and functions of the Committee, which include the powers under rule 6.02k to make monitoring visits to firms.

**6.03** Except where *rule 6.04* applies, the *Registration Committee* may delegate its duties to sub-committees, the *Institute's staff*, a *monitoring unit*, or another duly appointed agent.

The committee may delegate many of its powers except in the situations set out in rule 6.04.

**6.04** If the matters to be considered by the *Registration Committee* include:

- imposing restrictions or conditions on a *recognised auditor* under *rule 7.01*;
- recommending to the *registrar* the withdrawal of a firm's registration under *rules 7.03a, 7.03g, 7.03h, or 7.03i*;
- recommending to the *registrar* the suspension of a *firm's* registration under *rule 7.04*; or
- proposing a *regulatory penalty* under *rule 9.02*;

then:

- a the committee cannot delegate the decision;
- b at least one half of the committee members present must be accountants; and
- c at least one member of the committee present must not be an accountant.

Rule 6.03 allows the committee to delegate some of its duties to the Institute's staff.

However, rule 6.04 reserves certain specified decisions to the committee.

**6.05** When the *Registration Committee* has to decide if a *recognised auditor* has complied with a *rule, auditing standard, or a quality control standard* it must consider any relevant guidance in the rules, standards, *practice notes* and any guidance issued by *Council* or by the *Financial Reporting Council*.

**6.06** In carrying out its responsibilities under *rule 6.02*, the *Registration Committee*, any sub-committee, the *Institute's staff*, or a *monitoring unit* may, to the extent necessary for the review of a *firm's* audit work or how it is complying or intends to comply with the rules, require a *recognised auditor* to provide any information, held in whatever form (including electronic), about the *firm* or its clients and to allow access to the *firm's* systems and personnel.

Rule 6.06 gives the committee (or its delegated agents) power to call for information from a firm to help the committee carry out its functions. Requests may be to all firms on a routine basis through annual returns, or specific to individual firms.

**6.07** The *Registration Committee* may, for the purposes of the *rules*, treat as *audit work* any work carried out by a *recognised auditor* if such status is a requirement for that work.

This rule allows the committee to look at other work where the firm has signed a report as a recognised auditor. This is particularly so where a firm has little or no regulated audit work but is signing other reports as a recognised auditor. The committee may wish to review this work to assess the firm's ability to carry out audit work. Also, if a complaint is received about other work signed as a recognised auditor the committee may wish to review this or similar work for the same reason.

**6.08** All information obtained under *rule 6.06* will be confidential but may be disclosed by the *Institute* or a *monitoring unit* (directly or indirectly) to any person or body undertaking regulatory, disciplinary or law enforcement responsibilities for the purpose of assisting that person or body to undertake those responsibilities or as otherwise required or allowed by law.

All information that the Institute or a monitoring unit receives will remain confidential except in the above circumstances.

**6.09** A *firm* which is no longer a *recognised auditor* will continue to be subject to *rules 6.02k* and *6.06* if the enquiries or information relate to any period in which the *firm* was registered.

**6.10** In carrying out its responsibilities under *rule 6.02*, the *Registration Committee* may consider any disciplinary findings, orders, ongoing investigations or any other information concerning or affecting the fit and proper status of any *responsible individual*, the *firm* or its *principals*. In particular the *Registration Committee* may take into account the following:

- a any matter relating to any individual who is or will be employed by or associated with the *firm* in connection with *audit work*;
- b in the case of a *firm* that is a partnership, any matter relating to any:
  - 1) partner;
  - 2) *director* or *controller* of any of the partners;
  - 3) body corporate in the same *group* as of any of the partners; or
  - 4) any *controller* of any such body;
- c if a *principal* in the *firm* is a body corporate, any matter relating to any:
  - 1) *principal* or *controller* of that body corporate;
  - 2) body corporate in the same *group* as the body corporate; or
  - 3) *principal* or *controller* of any body corporate in that *group*;
- d in the case of a *firm* that is a body corporate, any matter relating to any:
  - 1) *principal* or *controller* of that *firm*;
  - 2) person having any interest in shares of the *firm*;
  - 3) body corporate in the same *group* as the *firm*; or
  - 4) *directors* or *controllers* of any body corporate in that *group*.

Rule 6.10 allows the Committee to consider any disciplinary or other matter that affects the fit and proper status of the firm. The scope is very wide and not limited to the principals in the firm.

Subparagraph (a) includes employees and associates of the firm. For partnerships, subparagraph (b) includes the partners, any director or controller of a partner that is a company, any other company that is in the same group as that company and any controller of any other group company. Subparagraph (c) deals with situations where a principal (ie a partner, member or director) is a body corporate.

So included are any director, member or controller of that body corporate, any other body corporate that is in the same group as that body corporate and any controller of any of those other bodies. Finally, subparagraph (d) deals with a firm that is a body corporate. Thus included are directors/members/shareholders of the firm, and any other body corporate that is in the same group as the firm and any controller of any of those other bodies.

### **Notification to committees**

- 6.11 The *Registration Committee* must notify the *Investigation Committee* about any fact or matter which:**
- a suggests that a *recognised auditor or responsible individual* may be liable to disciplinary action under the *rules* (see chapters 7 and 9), the *Bye-laws* or any other rule or regulation of the *Institute* (where applicable); and**
  - b in the opinion of the *Registration Committee* needs to be investigated.**
- 6.12 The *Investigation Committee* must inform the *Registration Committee* about any fact or matter which appears to it to be relevant to the powers and duties of the *Registration Committee* under the *rules*.**

Under rules 6.11 and 6.12, information may be exchanged between the Institute departments responsible for regulation and discipline.

### **Review Committee**

- 6.13 Certain matters decided by the *Registration Committee* may be considered afresh by the *Review Committee* (as described in *rule 8.06*). It may then carry out any of the responsibilities of the *Registration Committee* under *rule 6.02* and may make any order that the *Registration Committee* may make. In carrying out these duties, *rule 6.06* applies to the *Review Committee* as it applies to the *Registration Committee*.**

Firms may ask the Review Committee to reconsider a Registration Committee decision. This request must be made within a specified time period. Rules 8.05 to 8.07 give further details of how the review process works.

### **Appeal Committee**

- 6.14 Appeals against decisions of the *Review Committee* will be decided by the *Appeal Committee*.**

If a firm is dissatisfied with a decision of the Review Committee, it may apply for the case to be heard before the Appeal Committee. This request must be made within ten days of the decision being given to the firm.

Unlike applications for a review, the Appeal Committee will only hear an appeal on one of a number of specified grounds. It will not reopen the case from the beginning. The specific grounds are given in chapter 8.

Detailed procedures are given in rules 8.08 to 8.10.

The Appeal Committee's procedures and powers are given in the Bye-laws.

### **Procedures of the committees**

- 6.15** When considering any matter before it, the *Registration Committee*, the *Review Committee* or the *Appeal Committee* shall, for the purposes of the *rules*, accept any previous disciplinary finding, conviction, decision, sentence or judgement (including criminal and civil court decisions) as conclusive evidence of that prior matter.
- 6.16** Subject to the *Companies Law*, the *Bye-Laws* and the *rules*, the *Registration Committee*, the *Review Committee* or the *Appeal Committee* may, in carrying out their duties under the *rules*, decide on their own procedures.

This rule allows the committees to decide on their own internal procedures.

## CHAPTER 7 - REGULATORY ACTION

This chapter explains how the Registration Committee may take regulatory action against a recognised auditor.

Regulatory decisions come into effect as set out in rules 7.09 to 7.10.

Where, following monitoring by the FRC of the conduct of a market traded company audit, a sanction is imposed by the FRC in accordance with the recognised auditor sanctions procedure, then that sanction is to be treated as if it were a sanction determined by the Institute and will be enforceable as such.

The processes to be followed are set out in the FRC's Crown Dependencies' Recognised Auditor Regulatory Sanctions Procedure, a copy of which is available on the FRC's website at [www.frc.org.uk](http://www.frc.org.uk).

A firm may ask for a review of a decision made by the Registration Committee and this is dealt with in chapter 8. A firm must apply for a review within ten days of the decision being given to the firm.

### **Sanctions under the recognised auditor sanctions procedure**

**7.00** Where pursuant to an inspection by its monitoring unit of a *firm's audit work* the FRC has determined a *sanction* in accordance with the *recognised auditor sanctions procedure*, any such *sanction* shall take effect in accordance with the said procedure but shall be treated for the purposes of enforcement as though it had been determined by the Institute:

**7.00A** The *recognised auditor sanctions procedure* shall apply in respect of any *firm* which carries out *audit work* and is subject to monitoring by the FRC.

### **Restrictions and conditions**

**7.01** The *Registration Committee* may impose restrictions or conditions on a *recognised auditor* if it considers that:

- a any of the circumstances mentioned in *rule 7.03a to 7.03f* exist, or may exist, and the restrictions or conditions are justified;
- b the *firm* has not or may not have complied with the *rules* in the past, and the restrictions or conditions are justified;
- c the *firm* may not comply with the *rules* and the restrictions or conditions are justified;
- d continuing *audit work* without restrictions or conditions could adversely affect an *audit client* or any other person; or
- e it is appropriate to do so to ensure that *audit work* is undertaken, supervised and managed effectively.

## 7.01A [NOT RELEVANT]

**7.02** The *Registration Committee* may at any time vary or end a restriction or condition made under *rule 7.01*. Where a restriction or condition was made under the *recognised auditor sanctions procedure* and the *firm* has subsequently ceased to perform *audit work* the *Registration Committee* may only vary or end a restriction or condition with the agreement of the *FRC*.

The committee may place conditions on how a recognised auditor carries out or manages its audit work. These could be that a firm should undertake specified training, change its procedures or have 'cold reviews' of audit files by another recognised auditor.

The committee may place restrictions on a recognised auditor such as:

- that it cannot accept any new audits or particular types of audits;
- that a particular principal or employee may no longer be a responsible individual; or
- that an employee may no longer be involved in audit work.

Where conditions or restrictions are imposed by the committee, a firm will have to undertake to comply with the terms of the restriction or condition. Any failure to deal with these matters is likely to be viewed extremely seriously by the committee.

Where the committee imposes a restriction or condition and the firm subsequently comes into the monitoring jurisdiction of the FRC, the FRC may seek to vary the restriction or condition in consultation with the committee.

### Withdrawal of registration

**7.03** The *Registration Committee* may make a decision to recommend that the *registrar* withdraws a *firm's* registration if:

- a it considers that the *firm* no longer meets the eligibility requirements of *rule 2.01* or is no longer fit and proper to be a *recognised auditor*;
- b it considers that the *firm* is not complying with the *PII Regulations*;
- c the *firm* is over 30 days late submitting the required returns or reports (see *rule 6.06*);
- d the *firm* has not paid the registration fees due under *rule 2.13* or a charge due under *rule 2.15* (charge for a monitoring visit) within 60 days of the date of an invoice under *rule 2.16*;
- e the *firm* has not paid the costs in the time set by the *Review Committee* under *rule 8.07*;
- f the *firm* has not paid in the time set any fines or costs ordered by the *Investigation Committee*, the *Disciplinary Committee*, the *Appeal Committee* or under the *recognised auditor sanctions procedure*;

- g** it considers that the *firm* has not complied with any restriction or condition under *rule 7.01* or any written undertaking that the *firm* has given to the *Institute*;
- h** it considers that the *firm* has not complied with any other *rule* and, in the circumstances, recommendation of withdrawal is justified;
- i** it considers that the continued registration of the *firm* may adversely affect an *audit client* or any other person; or
- j** it considers that the *firm* has not complied with any restriction, condition or obligation imposed under the *recognised auditor sanctions procedure*.

The Registration Committee can, under rule 6.03, delegate its power to recommend the withdrawal of registration in the cases that come under paragraphs (b) to (f) of rule 7.03. However, under rule 6.04, only the committee can recommend the withdrawal of a firm's registration on the grounds of paragraphs (a), (g), (h) and (i) of rule 7.03.

The Registration Committee may, as an alternative to regulatory action, accept a written undertaking from a firm that it will undertake a particular course of action.

#### **7.03A [NOT RELEVANT]**

#### **Suspension**

**7.04** The *Registration Committee* may make a decision to recommend that the *registrar* suspends a *recognised auditor's* registration for a period if it considers that:

- a** any of the circumstances mentioned in *rule 7.03a* to *7.03g* exists or may exist;
- b** the *firm* is, or may, no longer be complying with the *rules*; or
- c** the continuation of the *firm's audit* activities could adversely affect an *audit client* or any other person.

#### **7.04A [NOT RELEVANT]**

**7.05** During a period of suspension a *recognised auditor*:

- a** need not resign from any appointment as auditor under the *Companies Law*;
- b** may accept re-appointment as auditor;
- c** must not accept any new appointments; and
- d** may only sign *audit reports* with the permission of the *registrar*.

**7.06** The *Registration Committee* may make a decision to recommend that the *registrar* vary or end the suspension of a *recognised auditor* that had been imposed following a recommendation under *rule 7.04*. Where a recommendation to the *registrar* to suspend

**a recognised auditor's registration was made under the recognised auditor sanctions procedure and the firm has subsequently ceased to perform audit work the Registration Committee may only recommend to the Registrar the varying or ending of the suspension with the agreement of the FRC.**

Where the committee had recommended to the registrar the suspension of a registration (and which the registrar had agreed to) and the firm subsequently comes into the monitoring jurisdiction of the FRC, the FRC may seek to recommend to the registrar the ending of the suspension in consultation with the committee.

### **Urgent orders**

**7.07 The Registration Committee may impose restrictions or conditions in the terms permitted by rule 7.01 by means of an urgent order if it considers that there is a need to do so.**

**7.08 Rule 7.07 is subject to the Registration Committee allowing the firm an opportunity to make oral or written representations within ten business days of the urgent order being made. Having considered any representations the committee may:**

- a end the order; or**
- b continue the order.**

Rule 7.07 allows the committee to take immediate regulatory action if the need arises. The committee would probably do this if there were serious allegations of fraud or other criminal activity or if there was a potential or actual loss of client money. As well as making immediate representations on the fact that an urgent order has been made, a firm can ask for a review or hearing of the underlying order under rule 8.05. The order comes into force when it is served on the firm (see rule 7.09) and is not lifted if a review is requested.

### **Implementation of committee decisions and orders**

**7.09 A decision made under rules 2.18, 7.03, 7.04, 7.07, or 8.09 will come into effect as soon as notice of it is served on the firm.**

The rules quoted in rule 7.09 relate to the following:

- dispensations given under rule 2.18;
- rule 7.03 deals with a recommendation to the registrar for the withdrawal of a firm's registration;
- rule 7.04 deals with a recommendation to the registrar for the suspension of a firm's registration;
- rule 7.07 concerns orders in respect of restrictions or conditions of registration that are made on a urgent basis; and
- rule 8.09 deals with Appeal Committee decisions.

**7.10 A decision made under rule 7.01 will come into effect ten business days after notice of it is served on the firm or any later time that the committee specifies, except:**



- a if a *firm* has applied for a review or hearing under *rule 8.05*, the order will be postponed until an order under *rule 8.06* has been put into effect; or
- b if a *firm* has appealed under *rule 8.08*, the order will be postponed until an *Appeal Committee* order under *rule 8.09* has been put into effect.

A decision made under rule 7.10 comes into effect ten business days after the firm has been given the decision. However, the decision listed in rule 7.10 is postponed if an application for review or appeal is made. The decision of the Review or Appeal Committee is the one that will come into effect.

The rule quoted in rule 7.10 relates to conditions or restrictions imposed under rule 7.01.

Rule 1.09 details how decisions and orders are served on firms.

**7.11 [NOT RELEVANT]**

**7.11A [NOT RELEVANT]**

**7.12 [NOT RELEVANT]**

**7.13 [NOT RELEVANT]**

**7.14 [NOT RELEVANT]**

**7.15 [NOT RELEVANT]**

**7.16 [NOT RELEVANT]**

## CHAPTER 8 - REPRESENTATION BEFORE COMMITTEES, REVIEW AND APPEAL

This chapter explains how a firm can apply for a review and appeal against a regulatory decision or proposed order of the Registration Committee. It also explains when a firm can be represented before a committee.

The rules in this chapter are not applicable in respect of any sanction determined under the recognised auditor sanctions procedure. The review and appeal process for those sanctions is set out in the FRC's Crown Dependencies' Recognised Auditor Regulatory Sanctions Procedure, a copy of which is available on the FRC's website at [www.frc.org.uk](http://www.frc.org.uk)

**8.01** In rules 8.02 to 8.10, “affected party” means a *firm* or a *responsible individual*.

### Representation before committees

**8.02** Only the following may attend a meeting of the *Registration Committee*:

- a members of the *Registration Committee*;
- b the secretary to the committee;
- c any member of the *Institute's* staff whose role is to advise or inform the committee on its responsibilities, duties, powers or procedures, including the *Bye-laws, rules* or the law; and
- d anyone else the committee permits.

**8.03** At meetings of the *Review Committee* and the *Appeal Committee*, the affected party, a representative or agent of the *Institute*, or a *monitoring unit* may attend and be represented. Witnesses may be present at the *Review Committee* and the *Appeal Committee* in accordance with the committees' procedures or *rules*.

**8.04** The *Registration Committee*, the *Review Committee* and the *Appeal Committee* may ask the affected party, the *Institute*, a *monitoring unit*, any employee or agent of the *Institute* to clarify relevant points. The affected party must be given the opportunity to comment on any clarification made by others.

### Review of regulatory decisions

A firm that is dissatisfied with a decision listed in rule 8.05 can apply for a review. A decision under rule 2.18 and 7.01 is postponed until the Review Committee's decision has been put into effect.

**8.05** Within ten *business days* of the *Registration Committee* serving a decision or order on a *firm* the affected party can apply to the *Review Committee* for a review of that decision or order. The affected party must apply in writing to the *Institute*. This applies to the following *rules*:

- |                  |   |  |
|------------------|---|--|
| <b>rule 2.18</b> | - | granting or refusing to grant a dispensation from the <i>rules</i> ; |
| <b>rule 7.01</b> | - | imposing restrictions or conditions;                                 |
| <b>rule 7.03</b> | - | recommending the withdrawal of registration;                         |
| <b>rule 7.04</b> | - | recommending the suspension of registration; or                      |
| <b>rule 7.07</b> | - | an urgent order.   |

Rules 7.09 and 7.10 explain when orders come into effect.

- 8.06** A meeting of the *Review Committee* will be arranged as soon as is practical after an affected party has applied under *rule 8.05*. The *Review Committee* will consider the matter afresh and will hear new material put forward by the affected party. The *Review Committee* may make any decision which the *Registration Committee* could have made.
- 8.07** The *Review Committee* may order an affected party to contribute to the costs of the review.

The Review Committee has the same powers as the Registration Committee when making orders against firms or responsible individuals. It can impose the same, more severe or less severe orders. It can also award costs. Costs are likely to be awarded if, for example, the affected party fails to attend the review when it said it would, does not send in further material it has promised, or the application is frivolous.

## **Appeal**

If a firm is dissatisfied with the Review Committee's decision it can apply to the Appeal Committee. The Appeal Committee can only consider an appeal on any of the grounds in rule 8.08. On appeal, the decision of the Review Committee is postponed until the Appeal Committee confirms or varies the decision (see rule 7.10).

The Appeal Committee has the power to accept or reject the appeal, or reduce the severity of the order. It cannot change the Review Committee's order in any other way, but it can ask the Review Committee to reconsider the order.

The Appeal Committee can also award costs against an applicant for an appeal.

- 8.08** Within ten *business days* of the *Review Committee* serving its decision on an affected party under *rule 8.06* the affected party can appeal to the *Appeal Committee* by writing to the *Institute*. An appeal can only be made on one or more of the following grounds:
- a that the *Review Committee*:
- 1) was wrong in law;
  - 2) wrongly interpreted any relevant *rule, Bye-law, auditing standard, quality control standard* or associated guidance; or
  - 3) did not comply with the *rules*, or procedures decided by the *Review Committee* under *rule 6.16*;
- b that the *Review Committee* made an order which no tribunal, correctly applying the law to the facts before it and acting reasonably, would have made; or

- c that there was evidence which the *Review Committee* had not considered and which:
  - 1) could reasonably have led the *Review Committee* to make a different order; and
  - 2) could not have been put before the *Review Committee* even if those concerned had done their best to produce it.

An appeal cannot be made if this is only against the costs awarded by the *Review Committee*. Rules 7.09 and 7.10 explain when orders come into effect.

**8.09** As soon as is practical after notice of appeal has been received under *rule 8.08*, the *Appeal Committee* will consider the appeal and may:

- a allow the appeal;
- b make a different decision;
- c send the matter back to the *Review Committee* to be considered again; or
- d dismiss the appeal.

**8.10** If the *Appeal Committee* sends a matter back to the *Review Committee* under *rule 8.09* then *rule 8.06* will apply when the *Review Committee* reconsiders. The meeting of the *Review Committee* to reconsider the matter will be arranged as soon as is practical.

**8.11** [NOT RELEVANT]

**8.12** [NOT RELEVANT]

**8.13** [NOT RELEVANT]

**8.14** [NOT RELEVANT]

**8.15** [NOT RELEVANT]

**8.16** [NOT RELEVANT]

**8.17** [NOT RELEVANT]

**8.18** [NOT RELEVANT]

**8.19** [NOT RELEVANT]

**8.20** [NOT RELEVANT]

**8.21** [NOT RELEVANT]

## CHAPTER 9 - DISCIPLINARY ARRANGEMENTS

The purpose of this chapter is to apply the disciplinary arrangements of the Institute to recognised auditors.

### 9.00 [NOT RELEVANT]

#### Application of disciplinary arrangements

9.01 The disciplinary arrangements of the *Institute* apply to complaints of breaches of the *rules* by a *recognised auditor* except that:

- (a) references in the disciplinary arrangements to a registered auditor shall be read as references to a *recognised auditor*;
- (b) for the power to withdraw registration there shall be substituted a power to recommend to the *registrar* that it withdraws the registration of the *recognised auditor*.

The disciplinary arrangements are set out in the Disciplinary Bye-laws.

#### Regulatory penalties

The Registration Committee may decide that a referral to the Investigation Committee to investigate an apparent failure to comply with the rules is not appropriate. Instead, with the agreement of the firm, the Registration Committee may propose a regulatory penalty. The following rules explain this process.

9.02 The *Registration Committee* may propose a *regulatory penalty* to a *recognised auditor* subject to the following:

- a the *recognised auditor* must have agreed that the breach of the *rules* has been committed;
- b the *Registration Committee* will decide the amount of the penalty and when it is to be paid. The *Institute* will set this out in the letter to the *recognised auditor* proposing the penalty; and
- c if the *recognised auditor* wishes to accept the terms on which the penalty is proposed, it must notify the *Institute* within ten *business days* of the date of service of the letter from the *Institute* containing the proposal.

9.03 There are no rights of review or appeal under *rules* 8.05 to 8.10 against a *regulatory penalty*.

9.04 The *Registration Committee* will take account of any comments a *recognised auditor* makes about the terms of the *regulatory penalty*. It may then reduce the amount of the penalty.

- 9.05** If the *recognised auditor* accepts the penalty under *rule 9.02c*, the *Registration Committee*, as soon as is practical:
- a will make an order; and
  - b may publish the order in any way it decides.
- 9.06** Details of any penalty accepted, and the order made, will be kept by the *Institute* and the *Registration Committee* may, if it wishes, use that information in the future.
- 9.07** Where the *Registration Committee* has proposed a *regulatory penalty* in accordance with *rule 9.02* but the *recognised auditor* does not agree that the breach has been committed, or does not agree to the terms of the penalty proposed or fails to comply with the terms of the penalty, the matter may be dealt with under the *Disciplinary Bye-laws*.
- 9.08** If a *recognised auditor* fails to comply with the terms of a regulatory penalty made under the *recognised auditor sanctions procedure* the matter may be dealt with under the *Disciplinary Bye-laws*.

Regulatory penalties are likely to be used, for example, where a firm has consistently been late in replying to letters from the committee or staff, has failed to submit annual returns, given incorrect information on the return and so on, or has not honoured undertakings given to the committee.

There is no right of appeal as a regulatory penalty can only be made with the firm's agreement. Once a matter has been settled by a regulatory penalty, there will be no further regulatory or disciplinary action against the firm on the matter. However, the details of the regulatory penalty will be put on the firm's record and may be taken into account in the future.

# *Part 2 - Guidance*

## CHAPTER 1 - GUIDANCE ON FIT AND PROPER STATUS

### **Background**

1. Rule 3.06 puts the responsibility on the firm to make sure that the principals and employees are and continue to be fit and proper. This chapter gives guidance to firms on this requirement.
2. [NOT RELEVANT]
3. [NOT RELEVANT]
4. [NOT RELEVANT]
5. [NOT RELEVANT]

### **Principals and employees**

6. Under the rules a recognised auditor must make sure that anyone who is or will be employed by, or associated with, the firm in connection with audit work is fit and proper.
7. A firm's procedures must cover:
  - the sole practitioner or the principals;
  - employees involved in audit work (including students);
  - consultants involved in audit work on the firm's behalf;
  - sub-contractors doing audit work on the firm's behalf; and
  - anyone else whose work a principal relies on when carrying out audit work.

Some of the auditing standards cover some common situations. These are:

- ISA 610 'Using the work of internal auditors'
- ISA 600 'Special considerations – audits of group financial statements (including the work of component auditors)'
- ISA 620 'Using the work of an auditor's expert'.

These should be followed where appropriate.

8. [NOT RELEVANT]

## **Partnerships and corporate practices**

9. The Companies Law recognises that partnerships may include one or more partners which are bodies corporate. In such a firm, the fit and proper procedures should extend beyond the corporate partner to any:
  - director or controller of the corporate partner;
  - body corporate in the same group as the corporate partner; and
  - director or controller of any body corporate above.
10. The fit and proper procedures should include those associated with a practice which is a body corporate. They are any:
  - director or controller of the body corporate;
  - other body corporate in the same group; and
  - director or controller of any body corporate above.

## **Procedures**

11. The procedures which a firm should introduce to assess the fit and proper status of principals, employees and others detailed above will vary depending on the size and structure of the firm.
12. An example of a 'fit and proper' form for individuals is at appendix B. All new recruits, employees newly involved in audit work and people who fall into the categories described in paragraphs 7 to 10 for the first time should be required to fill in such a form. Firms may find it easier to apply these procedures to all employees rather than make artificial distinctions.
13. At regular intervals a firm should have all principals and employees revise and update their last return or complete a new one. Firms might find it easier to update this information annually as part of their independence confirmation procedure or appraisal system. Principals and employees must be encouraged to immediately notify the audit compliance principal of anything that has a bearing on their fit and proper status. Firms are reminded that, in accordance with quality control standards, they should annually obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent.
14. **[NOT RELEVANT]**
15. The procedures in paragraphs 11 to 13 above may seem excessive for a sole practitioner with no employees. But a sole practitioner must be aware of the situations described in this guidance. The checklist provided in appendix B also applies to the sole practitioner. Rule 2.11 requires a firm to notify the Registration Committee of any matter that may bring the fit and proper status of the firm into doubt. Formal consideration of any matter raised by the firm could be recorded when the annual compliance review is completed.



## **Cause for concern or notification to the Registration Committee**

16. If a firm receives information, from any source, that indicates a principal or employee may not be a fit and proper person to be involved with audit work, the firm must evaluate its own fit and proper status. Matters a firm should consider include the:
  - seriousness of the matter;
  - timing of the event;
  - level of the individual's or body's involvement in audit work; and
  - likely risk to clients.
17. For example, a recent disciplinary finding against an audit principal would weigh more heavily than a ten-year-old finding of misconduct (and a reprimand by a professional body) against a tax principal who does not hold an appropriate qualification and so does not count towards control requirements and is not involved in audit work.
18. In the same way that a firm's failure to disclose information about its fit and proper status would jeopardise its continued registration, a failure by a principal, employee or other person to answer related questions truthfully would cast serious doubt on the suitability of the person to be involved in audit work.
19. If in doubt, the firm should notify the Registration Committee of the circumstances and the Registration Committee will advise on the firm's fit and proper status. The following are matters which should be reported:
  - offences involving dishonesty, fraud or cheating;
  - imprisonable offences under the Companies Law, financial services legislation, the law relating to insolvency, insider dealing, or similar laws in the areas of corporate or financial services;
  - conviction for any offence which involves a prison sentence;
  - serious breaches of regulatory legislation or requirements (e.g. a binding Code of Practice);
  - carrying out professional work in a grossly incompetent manner; and
  - carrying out professional work in a manner which does not comply with the FRC's ethical standards and relevant ethical pronouncements.

**Appendix A - [NOT RELEVANT]**

## **Appendix B - Example of a 'fit and proper' form for individuals**

Set out below are the questions that a firm should ask each principal, employee or other individual involved in or connected with audit work to allow the firm to assess the individual's fit and proper status. The answers will be 'yes' or 'no' but a 'yes' will need further explanation.

Yes No

### **Financial integrity and reliability**

- |   |  |                          |                          |
|---|--|--------------------------|--------------------------|
| 1 | In the last ten years have you made any compromise arrangement with your creditors or otherwise failed to satisfy creditors in full?                                       | <input type="checkbox"/> | <input type="checkbox"/> |
| 2 | Have you ever been declared bankrupt, or has a bankruptcy petition ever been served on you?  | <input type="checkbox"/> | <input type="checkbox"/> |
| 3 | Have you ever signed a trust deed for a creditor, made an assignment for the benefit of creditors, or made any arrangements for the payment of a composition to creditors? | <input type="checkbox"/> | <input type="checkbox"/> |

### **Civil liabilities**

- |   |   |                          |                          |
|---|---|--------------------------|--------------------------|
| 4 | In the last five years have you been the subject of any civil action relating to your professional or business activities which has resulted in a judgement or finding against you by a court, or a settlement (other than a settlement consisting only of the dismissal by consent of a claim against it and the payment of its costs) being agreed? | <input type="checkbox"/> | <input type="checkbox"/> |
|---|---|--------------------------|--------------------------|

### **Good reputation and character**

**Note:** There is no need to mention offences which are spent for the purposes of Rehabilitation of Offenders legislation in each respective Crown Dependency, offences committed before the age of 17 (unless committed within the last ten years) or road traffic offences that did not lead to a prison sentence.

- |   |   |                          |                          |
|---|---|--------------------------|--------------------------|
| 5 | Have you at any time pleaded guilty to or been found guilty of any offence?   | <input type="checkbox"/> | <input type="checkbox"/> |
|   | If so, give details of the court which convicted you, the offence, the penalty imposed and date of conviction.  | <input type="checkbox"/> | <input type="checkbox"/> |
| 6 | Have you ever been disqualified by a court or other relevant authority from being a director, or from acting in the management or conduct of the affairs of any company?                              | <input type="checkbox"/> | <input type="checkbox"/> |
| 7 | In the last ten years have you been:  |                          |                          |
|   | • refused the right or been restricted in the right to carry on any trade, business or profession for which a specific licence, registration or other authority is required?                          | <input type="checkbox"/> | <input type="checkbox"/> |
|   | • investigated about allegations of misconduct or malpractice in connection with your professional activities which resulted in a formal complaint being proved but no disciplinary order being made? | <input type="checkbox"/> | <input type="checkbox"/> |
|   | • the subject of disciplinary procedures by a professional body or employer resulting in a finding against you?   | <input type="checkbox"/> | <input type="checkbox"/> |

- reprimanded, excluded, disciplined or publicly criticised by any professional body which you belong to or have belonged to?
  - refused entry to or excluded from membership of any profession or vocation?
  - dismissed from any office (other than as auditor) or employment or requested to resign from any office, employment or firm?
  - reprimanded, warned about future conduct, disciplined, or publicly criticised by any regulatory body, or any officially appointed enquiry concerned with the rule of a financial, professional or other business activity?
  - the subject of a court order at the instigation of any regulatory body, or any officially appointed enquiry concerned with the rule of a financial, professional or other business activity?
- 8 Are you currently undergoing any investigation or disciplinary procedures as described in 7 above?

## CHAPTER 2 - GUIDANCE ON MONITORING COMPLIANCE WITH THE RULES

### **Introduction**

1. Rule 3.20 requires a recognised auditor to monitor its compliance with the rules. This is a key part of the overall system of audit regulation.
2. Many firms will already be carrying out internal monitoring, quality assurance or practice reviews. The term 'audit compliance review' (ACR) is used in this guidance and also on the annual return.
3. This guidance will help firms, whether sole practitioners or larger firms, to monitor their compliance with the rules cost effectively and efficiently.

### **Why is an audit compliance review required?**

4. All kinds of enterprises conduct periodic reviews to assure management that proper safeguards are in place to lessen the likelihood of sub-standard goods and services being produced or supplied. Auditing is a complicated process involving a series of professional judgements culminating in the audit opinion. Whether this is a product or service, testing that it is of a satisfactory standard is just as important for a recognised auditor as it is for any other organisation. This may be increasingly relevant where there is a public interest in the firm's clients.
5. The firm's principals are effectively collectively responsible for the work of the firm, and they will want to satisfy themselves that the audit work is being done according to the rules.
6. Many firms, of all sizes, use reviews to assess the effectiveness of the way that they conduct their work - not only audit. A review can be a powerful tool to improve working practices. The questions in this type of review go far beyond testing the firm's compliance with the rules and could include such fundamental questions as:
  - Is the firm providing the service to its clients that they need and want?
  - Is the firm sufficiently paid for those services?
7. The nature of the questions asked depends on the objectives of the review. This guidance is intended to help firms meet the requirements of rule 3.20.

### **What is an audit compliance review?**

8. An ACR is to assure the firm that it has complied with the rules which require a recognised auditor to carry out audits according to ethical standards and comply with auditing and quality control standards. These in turn require the firm to have certain procedures and arrangements in place for its audit work.

Appropriate documentation should exist which sets out the monitoring procedures, records the evaluation, and identifies the deficiencies and any further action.

## **What is involved in an audit compliance review?**

9. In many ways an ACR is an internal audit of the way a firm conducts its auditing work. Because each firm is unique, through its principals, employees and clients, there is no single approach that will suit all firms.
10. An ACR is usually in two parts. The first part, the 'whole firm' is about how the audit practice works. The second part is about 'cold file reviews' and asks how a sample of audit assignments has been completed. The expression 'cold file review' has been used in the profession for many years - the review is 'cold' because it takes place after the whole audit process has been completed and the audit opinion given. It provides assurance to the firm that the quality control procedures which are built into the audit process have worked satisfactorily.
11. As part of their quality control procedures some firms also carry out 'hot' reviews (that is before the audit report is approved). The ACR programme would check that, if necessary, the required hot reviews have taken place.
12. There are many commercial ACR programmes and checklists available for firms to use. Compliance principals or sole practitioners should consider their own practices and amend these programmes as necessary so that the ACR is appropriate to their firm.
13. Cold file reviews are an important part of the ACR but how many client files should be cold reviewed? Some firms will select audits for a particular reason (for example because it is a high risk audit or perhaps a new client) and then a sample of other files. However, monitoring experience has shown that there is a law of diminishing returns. If a single file is representative of a principal's work then that can reveal virtually all that is needed and little may be gained from doing more. A representative sample of two or three audits for each principal should be enough.

## **Who might carry out the audit compliance review?**

14. Although the main purpose of an ACR is to assure a firm that it is complying with the rules, there is a further important aim. This is to add value to the audit practice, either by identifying potential areas for improvement or by giving assurance that everything is satisfactory. For both reasons the review must be done effectively. A half-hearted attempt which fails to identify significant risks or inefficiencies would be a waste of time and give a false sense of security.
15. The first step is to identify the person best placed to conduct the review. The monitoring process should be entrusted to a principal, principals or other persons with sufficient and appropriate experience. The choices are someone from:
  - within the firm;
  - another recognised auditor;
  - the Institute or another professional body; or
  - a specialist organisation, such as a training consortium which provides a review service.
16. Sole practitioners, firms with only one responsible individual and other small firms should note that ISQC1 does not permit the responsible individual or the engagement quality control reviewer for a particular audit to undertake a cold file review of that audit. It may be that there is another individual in the firm who, although not a responsible individual, is very experienced in current auditing requirements. Assuming that this individual did not take part in the audit, the firm may decide this individual would be a suitable person to undertake the review. If this is not possible, then the firm should use an external reviewer at least once every three years.

17. The whole firm aspects of the review could be dealt with by completing the annual return. However, an individual practitioner might find it difficult to remain objective in cold reviewing his or her own completed assignments. The tendency will be to fill gaps in the audit process from memory and not to see that the audit evidence or process is deficient. Therefore, it is better to use someone independent of the assignment for the cold file review. As mentioned above, this may be necessary for small firms on a periodic basis.
18. Qualified employees within the firm can do the detailed cold file reviews. Some firms feel that, as a principal approved the issue of the audit opinion, only principals should do cold file reviews. There is an obvious anxiety for an employee in criticising the work of the person who decides future salaries. The most common approach is to have a combined team of principals and staff. However, it may be more helpful to the person being reviewed if the feedback is given by someone of equal standing and authority. A person who has had experience of being a responsible individual can add those touches of practicality which come from dealing with clients and add further benefits to the process. Also, the individual should not have had any previous involvement in the particular audit.
19. If an ACR is to add value, those doing the review must be technically up to date and have experience of assignments similar to those being reviewed. It can also save time if that person knows how the firm carries out its audits. For a sole practitioner, a suitable person may be the alternate or consultant for technical matters, provided they had not been consulted on the particular audit.
20. Any outsider doing the ACR should complete a confidentiality declaration. An outsider who is an Institute chartered accountant would, of course, also be bound by the Institute's Code of Ethics and would have to seek the consent of the firm before acting for any of its clients.
21. Both the reviewer and the reviewed can learn from the experience. Much benefit can be obtained from two sole practitioners, who have no employees, meeting for an afternoon and reviewing one of the other's completed audit files. That would leave each sole practitioner to complete the whole firm part of the ACR.

### **When should the audit compliance review be carried out?**

22. Rule 3.20 requires a recognised auditor to monitor compliance with the rules at least once a year. The following paragraphs explain how this can be done.
23. The ACR is based on verifying that effective action is taken to mitigate the risk to the firm of not complying with the rules and of producing poor audit work. Problems can arise because the people making decisions are stressed; there are changes in a client's business; there are changes to the law or to accounting or auditing standards. It may therefore be appropriate for the scope of the ACR to focus on any changes that may have amended the previous risk assessment. So, for example, cold reviews may concentrate on how the firm has adapted its procedures to implement a new auditing standard. The timing and frequency of the ACR should take all these factors into account. This calls for flexibility in the timing and the programme of work.
24. If the ACR identifies matters that have gone wrong, the firm will want to deal with that risk as soon as possible. This suggests that the ACR should be done early enough so that any changes can be made to the firm's procedures before the reviewed audits (and others) are started for the next year.

## **What should be the scope of the audit compliance review?**

25. The ACR would normally be in two parts. The first part would cover a firm's obligations under the rules such as:
- independence and integrity;
  - fit and proper status;
  - competence;
  - appointment and reappointment;
  - professional indemnity insurance; and
  - continuing eligibility.

and under ISQC1 such as:

- leadership responsibilities;
- human resources; and
- complaints.

It is relatively easy to determine the scope of the work needed each year for this part.

26. The second part would deal with reviews of completed audit work to ensure that the firm's audit process had been followed and the audit reports issued are appropriate. Deciding how much work to do for this is more difficult and involves judgements on the number and frequency of reviews.
27. For many firms the easiest way is simply to decide that the work of each principal and senior employee should be reviewed each year. Completed audit files would be then selected and reviewed to make sure that the work was in accordance with the auditing standards and the firm's procedures.
28. Firms may have well-defined procedures to control the quality of the work produced and to make sure appropriate audit opinions are given. This will be a factor in deciding how frequently each principal's work is reviewed. Other factors might be the rate of employee turnover and the number of clients that the firm has identified as high risk. So while some files will be reviewed every year, the work of each principal and senior employee will not. However, even the most well-organised firm should review the work of each principal at least every three years. In other circumstances the timing may need to be more frequent.
29. For a firm with only one responsible individual, much of the quality control of the work produced depends on that individual's final review. Additional factors to those above may be relevant in deciding the frequency of cold file reviews. For example, the size of the audit portfolio and factors affecting the audit work such as new auditing standards or new disclosure requirements. In a period of change, it would be sensible if, at least once a year, a sample of audit files were cold reviewed.

## **What should happen after the audit compliance review?**

30. All the ACR work needs to be documented so that the detailed findings can be discussed with the responsible individual in charge of the audit. This discussion should start with the positive points and then with any points that show change may be needed. If action is needed the timing should be agreed. The effect of the deficiencies should be evaluated and the firm should determine if the audit reports issued are appropriate or if they require prompt corrective action. Where there are a number of people with whom there are post-ACR discussions, the findings need to be consolidated to give an overall view.



31. The summary must be kept to plan future ACRs and to confirm that follow-up action has been taken as agreed. This summary, without identifying which clients' affairs were reviewed, could be the means of disseminating the results of the ACR within the firm. At least annually, the firm should communicate the result of the ACR within the firm. Information communicated should include a description of the monitoring procedures performed, the conclusions drawn, a description of the deficiencies, and action taken. Once the summary has been prepared and the results communicated, unless a monitoring visit has been arranged, the detailed ACR papers can be shredded.
32. The annual return asks questions about the firm's ACR. The first question asks when the most recent ACR was completed. If a firm uses the annual return for considering the whole firm aspects of ACR, then the time of completion is the date when the annual return was completed.
33. When the ACR is finished there must be feedback to those involved. That feedback should answer two questions:
  - What should we do exactly the same way next time because it was successful?
  - What should we do differently next time in order to be more successful?

### **Conclusion**

34. An ACR takes time and other resources. To justify that expenditure the exercise needs to be planned and carried out effectively. And it is essential that the reporting is honest. Otherwise those involved in audit work may be falsely reassured.
35. Being 'in practice' implies learning through experience. The ACR is a powerful way of making sure this happens, regardless of any requirement set out in the rules. It can have real impact on the quality of work, its efficiency, and the motivation of everyone involved. Firms want to do their work properly and gain satisfaction from it, but improvements cannot be made unless the areas needing adjustment are identified. The ACR is not an imposition, but a way to help firms do work they can be justly proud of.

## CHAPTER 3 - GUIDANCE ON DESIGNATING RESPONSIBLE INDIVIDUALS

### Introduction

1. Rule 4.01c requires that the audit compliance principal of an audit firm, before designating a principal or employee of the firm as a responsible individual, is satisfied that he/she is competent to conduct audit work in relation to market traded companies.

### Guidance

2. This chapter provides guidance for audit compliance principals by setting out questions that he/she should consider when assessing whether a principal or employee of the firm is competent to be designated as a responsible individual. This list of questions should not be considered exclusive: a firm may wish to take other factors into account.
3. The answers will be 'yes' or 'no'. Where an answer of 'no' is given against any question the firm would be expected to consider carefully whether it is appropriate for the individual to be designated as a responsible individual.
4. In assessing the suitability of a principal or employee to be a responsible individual, a firm would be expected to refer to the 'continuing professional development' records maintained by the principal or employee.
5. It is important for firms to remember that assessing competency is not a one-off exercise. A firm should have arrangements in place to monitor the competency of responsible individuals on an ongoing basis to ensure that their designation remains appropriate (see rule 3.17).
6. A rule that is of particular relevance to a question below is given in square brackets thereafter.

### Questions

- |  | Yes                      | No                       |
|--|--------------------------|--------------------------|
| 1 Does the individual have significant experience of auditing companies <sup>1</sup> in the Crown Dependencies, the United Kingdom or the Republic of Ireland at a senior level?   | <input type="checkbox"/> | <input type="checkbox"/> |
| <u>Note.</u> Factors that would be likely to warrant an affirmative response would include:-   |                          |                          |
| <ul style="list-style-type: none"><li>• the individual having at least 24 weeks' auditing experience during the last 2 years at a senior level;</li><li>• the individual having been granted 'responsible individual' status by the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants of Scotland, the Institute of Chartered Accountants in Ireland, or the Association of Chartered Certified Accountants.</li></ul> |                          |                          |
| 2 Does the individual have a sound knowledge of the fundamental principles set out in the Code of Ethics and the ethical standards that apply in respect of the firm's audit work? [Rule 3.02]   | <input type="checkbox"/> | <input type="checkbox"/> |

<sup>1</sup> For the avoidance of doubt - any type of company, not solely market traded companies.

- |    |   |                          |                          |
|----|---|--------------------------|--------------------------|
| 3  | Does the individual have a sound knowledge of those parts of the relevant Crown Dependency's Companies Law that are applicable to auditing and auditors? [Rules 3.08 and 3.19]                      | <input type="checkbox"/> | <input type="checkbox"/> |
| 4  | Does the individual have a sound knowledge of the auditing standards that will apply to those audits for which he/she will be responsible? [Rule 3.10]  | <input type="checkbox"/> | <input type="checkbox"/> |
| 5  | Does the individual have a sound knowledge of the quality control standards that apply in respect of the firm's audit work? [Rule 3.10]   | <input type="checkbox"/> | <input type="checkbox"/> |
| 6  | Does the individual have a sound knowledge of the procedures that the firm depends on to ensure that it does audit work competently? [Rule 3.19]  | <input type="checkbox"/> | <input type="checkbox"/> |
| 7  | Does the individual have a sound knowledge of the Audit Rules and associated guidance? [Rule 3.19]  | <input type="checkbox"/> | <input type="checkbox"/> |
| 8  | Does the individual have a sound knowledge of the accounting principles that will apply to those audits for which he/she will be responsible?   | <input type="checkbox"/> | <input type="checkbox"/> |
| 9  | Do the firm's recent internal performance appraisals of the individual confirm that there are no doubts as to his/her competency?   | <input type="checkbox"/> | <input type="checkbox"/> |
| 10 | Is the audit compliance principal satisfied that in the last three years the individual has not been:   |                          |                          |
|    | • refused the right to audit, been restricted in the right to audit, or been required to submit to enhanced supervision when auditing (in each case, either by a professional body or an employer)? | <input type="checkbox"/> | <input type="checkbox"/> |
|    | • investigated, by a professional body or employer, about allegations of incompetence in connection with their auditing duties?   | <input type="checkbox"/> | <input type="checkbox"/> |
|    | • the subject of disciplinary procedures by a professional body or employer resulting in a finding against them which raises doubts as to their competence when auditing?                           | <input type="checkbox"/> | <input type="checkbox"/> |
|    | • the subject of any civil or criminal proceedings that cast doubt as to the individual's competence when auditing?   | <input type="checkbox"/> | <input type="checkbox"/> |

11 Is the audit compliance principal satisfied that the individual is not currently the subject of any investigation or disciplinary procedures that may cast doubt as to the individual's competence when auditing?

12 Overall, is the audit compliance principal satisfied that the individual is competent to be designated as a responsible individual?

**Note:**

The audit compliance principal should document how he/she came to the 'yes' or 'no' answer to question 12.