

**EC Recommendation on  
Statutory Auditor's Independence in the EU  
and Comparison with the Independence Section  
of the IFAC Code of Ethics for Professional Accountants**

**Considerations  
on the Implementation  
of the Framework Approach**

**October 2004**











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## INTRODUCTION

The purpose of this paper is to provide an overview of the requirements of the European Commission (EC) Recommendation of 16 May 2002 on “Statutory Auditor’s Independence in the European Union (EU): A Set of Fundamental Principles” (EC Recommendation).

An individual’s objectivity must be beyond question if he<sup>1</sup> is to report as an auditor. That objectivity is assured if the auditor is, and is seen to be, independent. The paper identifies, in respect of each area of potential concern, the possible threats to the auditor’s independence and suggests the thought processes that might be followed to establish the safeguards necessary to reduce or eliminate them. It also compares the requirements of the EC Recommendation to that of the independence section of the International Federation of Accountants Code of Ethics for Professional Accountants (IFAC Code of Ethics) and identifies key differences.

The full text of the EC Recommendation compared to the IFAC Code of Ethics in respect of each area covered is reproduced at Appendix 1, and is preceded by a “Glossary and Definitions” section.

A comparative overview of the essence of the EC Recommendation and the equivalent IFAC Code of Ethics, together with commentary on the main differences is set out at Appendix 2.

### *1. Background*

An audit provides stakeholders with assurance that management has given an impartial analysis of the financial position of organisations in which they have an interest. The reliability and credibility of the financial information it provides determines, amongst other things, the ability of investors to make rational choices and thus underpins the efficient functioning of capital markets. Poor information will therefore act as a brake on economic progress as well as harming the interests of individuals. Hence governments regard audit quality as a public interest matter.

The relevant section of the IFAC Code of Ethics, published in November 2001, addressing issues related to independence in assurance engagements and the EC Recommendation published in May 2002, dealing with the independence of statutory auditors, are very similar in that they are both based on the same approach, use the same concepts and provide and suggest the same assessments of practical situations.

For instance, both existing texts use the same framework in providing a threats and safeguards approach, and both texts identify situations and suggest solutions where the independence of the statutory auditor is at stake.

Many of the similarities arise because both texts are based on an initiative launched by the European accountancy profession, which sought to establish a framework that could anticipate and react to the expectations of its environment.

In July 1998, FEE published a paper entitled: “Statutory audit independence and objectivity - common core of principles for the guidance of the European profession initial recommendations”. This paper was an attempt to react to a trend in the existing guidance in several EU countries towards the identification of a constant growing number of detailed areas of potential risks, but with an absence of any persuasive rationale or principles. This initiative was also based on the clear recognition that is

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<sup>1</sup> Words denoting one gender shall include all genders and words in singular shall include the plural and vice versa.

was unrealistic to think that a professional regime consisting of a constantly growing set of detailed rules, would render professionals free from any real or perceived threats to independence and objectivity.

On the contrary, the paper clearly recognised that all practising accountants are constantly faced with threats to their objectivity in real life. This is particularly obvious for a statutory auditor with the threat that the auditor is remunerated by the client. All these elements led to the conclusion that the main purpose of professional guidance should be to enable auditors to identify threats and risks which affect this situation to such an extent as might compromise their professional judgment.

The key concern of this approach is whether the objectivity of an audit is likely to be affected by extraneous factors, in particular by factors that might affect the auditor's independence such as a personal financial interest in a company he is auditing. National systems of audit regulation have different approaches to imposing requirements on auditors to avoid situations where their independence would be threatened.

To some extent, the distinction between a conceptual and a rule-based approach is a false dichotomy. In a rule-based system the conceptual framework may not be explicitly stated, but if the rules are consistent, they must follow an underlying common principle. For example, a rule that auditors may not own shares in a client company is one means of seeking to achieve the underlying aim that an auditor's independence must not be compromised.

However the way in which the ethical requirements are expressed can have significant consequences for their enforceability. In the case of auditor independence, there is broad agreement on the underlying objectives. The real issue is whether enforcement will be more effective if the "law" is the conceptual framework itself or is a series of discrete rules derived from the framework.

Proponents of the rule-based approach argue that black and white requirements leave no room for misunderstanding or evasion. However, precisely defined rules can be evaded through arrangements that adhere to the letter but offend against the spirit of the rules. An example may help to illustrate the point. A financial institution offers a derivative instrument that closely tracks companies' performance. A literally interpreted rule that prohibits an auditor from having an ownership interest in his clients would not prevent him from holding such an instrument even though his financial interest would be equivalent to that of a shareholder. Furthermore, in a rule-based system new rules must constantly be developed to meet new circumstances.

Proponents of the conceptual approach argue that by focusing on the underlying aim rather than detailed prohibitions, it combines flexibility with rigour in a way that is unattainable with a rule-based approach. In particular, it:

- Allows for the almost infinite variations in circumstances that arise in practice;
- Can cope with the rapid changes of the modern business environment;
- Prevents the use of legalistic devices to avoid compliance;
- Requires auditors to consider actively, and to be ready to demonstrate the efficacy of arrangements for safeguarding independence.

Accordingly, in a rapid evolving modern global economy, it is impractical to list comprehensively all potential threats to ethical behaviour and independence issues. In fact, such an approach is open to the danger of ignoring potential threats not specifically addressed or detailed in a set of rules. This is essentially the reason why FEE supports a conceptual approach to ethical standard setting supplemented by appropriate guidance, restrictions and in certain situations prohibitions.

The benefits of the threats and safeguards approach is recognised in the recently issued draft revision to the Eighth Company Law directive on the statutory audit of annual accounts and consolidated accounts. When adopted this will provide an appropriate legal underpinning of the conceptual approach to independence for statutory auditors all over Europe. FEE welcomes this initiative, as this will endorse the threat and safeguards approach used in both the EC Recommendation and IFAC Code of Ethics.

## ***2. The Conceptual Approach***

Outlined in broad terms, the conceptual approach works as follows:

- Fundamental principles are set out which must always be observed by a professional accountant. (In the case of audit, the subject of this guidance, the relevant fundamental principle is objectivity, which necessarily requires the professional accountant to be independent);
- The auditor must conscientiously consider, before taking on a piece of work, whether it involves threats which would impede the observance of the fundamental principles;
- Where such threats exist, the auditor must put in place safeguards that eliminate them or reduce them to clearly insignificant levels;
- If the auditor is unable to implement fully adequate safeguards, he must not carry out the work. In this particular situation, prohibition should be regarded as an ultimate safeguard.

For many years, FEE has taken the view that clear principles duly and consistently respected, supplemented by some rules ensuring their proper application in particular circumstances, have several benefits as the basis for standards. Principle-based standards are intellectually robust, they can be applied to any set of circumstances which may arise in practice and they can cope with the detail and complexity of a particular case. They focus on what is important, e.g. financial information which is useful for decision-making. They prevent “technical” evasion of detailed rules and they avoid excessively voluminous and therefore impracticable detailed rules which in practice cannot address every circumstance which will arise and may easily become outdated. They are also easier to apply in a multi-jurisdictional environment such as the European Union.

Regarding the auditor’s objectivity and independence, principle-based standards are the most demanding in the sense that they prohibit auditors from providing services which compromise their independence. They require auditors to discuss their independence regularly with their clients’ audit committees or equivalent bodies; they also require a detailed disclosure of fees and services provided to their audit clients. They reinforce the importance of independence as a constant imperative for individual audit partners and engagement teams, as those individuals are required to document and take responsibility for judgement about independence both when considering the acceptance of audit and non-audit assignments and during the performance of such assignments. This is a continuous and demanding procedure, which is subject to quality assurance controls and discipline. Principle-based standards generally contain guidance, restrictions and some prohibitions in relation to particular circumstances and relationships, designed to assist the audit partners and engagement teams when considering the acceptance of audit and non-audit assignments, for example a cooling-off period in respect of key audit partners joining their audit client. They also offer the best opportunities for European and globally consistent independence arrangements for auditors, thereby avoiding an increasingly complex “patchwork quilt” of national regulations and codes which are frequently applied on an extra-territorial basis.

The ethical guidance of bodies that use the conceptual framework approach includes examples of threats that might arise and appropriate safeguards to deal with them. But these are clearly illustrative and not comprehensive. If an auditor were to appear before a disciplinary tribunal charged with a breach of ethical requirements, it would not be a sufficient defence to demonstrate that particular examples of threats and safeguards in the ethical code had been addressed. He would need to be able to demonstrate that, in the particular circumstances under consideration, the fundamental principles had in fact been observed – a far more rigorous test of compliance.

### ***3. Nature of the Threats***

In order to avoid or resolve certain situations, facts or circumstances that might impair independence of the auditor, it is crucial to properly identify the various threats to independence which may arise in specific circumstances. But the auditor must also assess their significance in order to determine the level of risk he may be confronted with.

It should be noted that both the EC Recommendation and the IFAC Code of Ethics, although the wording which is used may be slightly different, provide the same identification of threats. Based on their nature, the following types of threats are identified:

- The self-interest threat: a threat to independence and objectivity stemming from a financial or other self-interest conflict;
- The self-review threat: the difficulty of maintaining objectivity in certain specific circumstances or when any product or judgement of a previous audit or non-audit assignment performed by the auditor needs to be challenged or re-evaluated in reaching the current audit conclusions;
- The advocacy threat: a threat to the auditor's objectivity if he becomes an advocate for or against his client position in any adversarial situation or proceeding;
- The familiarity threat: a threat that the auditor may become over-influenced by the client personality and qualities, and consequently too sympathetic to the client's interests;
- The intimidation threat: the possibility that the auditor may be intimidated by a dominating personality or by other pressures, actual or feared, at the client or an associate of the client or some other party.

When the auditor is confronted with one of those threats, he should always consider the use of appropriate procedures and safeguards which may eliminate the threats or reduce them to insignificant levels.

When evaluating the significance of a threat the auditor has also to consider that different kinds of threats may arise in one set of circumstances. A threat can be considered as significant if, considering all of its quantitative and qualitative aspects, both alone and in combination with others, it increases the independence risk to an unacceptable level.

In particular cases, the conceptual approach can be virtually indistinguishable from rule making. For example, the EC Recommendation and the IFAC Code of Ethics state that holding or dealing in securities of an audit client constitutes such a severe threat to independence that there are no adequate safeguards. This threat results in a prohibition of performing the envisaged assignment.

The key to the success of the conceptual approach is the effectiveness of the safeguards. These apply at three levels: safeguards in the work environment, safeguards that increase the risk of detection, and specific safeguards to deal with particular cases.

## **4. Safeguards**

### ***Safeguards in the Work Environment***

The FEE professional bodies' concern for the reputation of their members has led them to take great care that their educational requirements, both in the initial training for their qualifications and in subsequent compulsory continuing professional education, include a thorough understanding of ethical matters. Therefore, there is little risk that a qualified member of a professional accountancy body could reasonably claim to be unaware of the ethical code that he must observe.

Systems of corporate governance are playing a growing role in ensuring that threats to independence do not arise. Most FEE member countries have legal or regulatory requirements for the involvement of persons independent of companies' management in decisions on audit. Audit committees are increasingly involved in the selection and reappointment of auditors and in awarding non-audit work to auditors.

Transparency is also an important factor. In several European countries it is now a legal requirement for information to be published on the magnitude of audit and non-audit fees received by auditors from audit clients. Some countries go further and require publication of a breakdown of non-audit services, distinguishing between those which are most effectively and economically provided by the company's auditor and those which could equally well be provided by other firms. All of this is intended to help to ensure that there is a better public understanding of how heavily an audit firm depends on income from particular clients.

Disciplinary penalties are severe. Auditors in all FEE member countries are aware that if they breach the ethical requirements of their professional bodies they may be subject to sanctions which are made public (damaging to their business reputation), heavy fines, and ultimately withdrawal of their licence to practise.

### ***Safeguards Affecting the Risk of Detection***

Accountancy is a profession governed by principles, and for the great majority of accountants knowledge and understanding of the ethical code will in itself be sufficient to prevent infractions. In any group of people, however, there will be those who wish to cross the boundaries. To deter them, an increased risk of detection is of key importance.

Members of many professional accountancy bodies are subject to an explicit duty to report breaches of ethical requirements. The failure to report such a breach is itself a disciplinary offence that could attract severe penalties. Those contemplating unethical behaviour therefore do so in the knowledge that if a colleague learned of their unethical behaviour he would be under great pressure to ensure that it be brought to light.

All the FEE professional bodies also have effective complaints systems, which enable clients and members of the public to draw attention to unprofessional behaviour. The arrangements are publicised, and the complaints are dealt with by highly qualified staff. Many of the bodies require firms to inform clients explicitly and in writing of their right to complain and how to do so.

For firms practising in statutorily regulated areas such as audit, there are special arrangements for monitoring by the professional bodies. Detailed arrangements vary, but the underlying purpose is the same: to provide independent verification of compliance with the professional bodies' requirements.

In most, if not all, EU countries, external quality assurance systems are in place. They can be either a monitored peer review system or a monitoring unit. For example, the professional bodies with practising accountant members have monitoring units, staffed by professionally qualified inspectors, which visit each of the biggest accountancy firms every year and other firms at a frequency determined by a risk-based analysis. Inspection visits to audit firms include questions specifically designed to establish the effectiveness of procedures for preserving auditor independence and the inspectors examine the firm's records and files to establish the accuracy of the response. This procedure is assisted by the requirement in the relevant auditing standards or code of ethics that the practitioner should be able to demonstrate his consideration of independence issues in each case.

Monitoring by the professional bodies is itself subject to external supervision. There are a variety of arrangements in FEE member countries for oversight by governmental authorities or regulators.

### *Specific Safeguards*

The EC Recommendation and the IFAC Code of Ethics include examples of specific safeguards that must always be considered and safeguards that apply to particular cases.

*Safeguards that must always be considered when conducting an audit include:*

- A high-quality overall control environment;
- Provision for staff to communicate any concerns to a separate principal in the firm;
- Arrangements for a partner not involved in the conduct of the audit to act as reviewer or reviser;
- Involvement of a third party (such as a committee of directors independent of the management of the company being audited, a professional body, or another auditor);
- Compartmentalisation of responsibilities and knowledge;
- Explanation of the steps taken to deal with the risk of conflicts;
- A prohibition when the risk remains too high.

In all cases, unless the auditor is satisfied these safeguards will be sufficient to eliminate the threats to independence, or reduce them to clearly insignificant levels, he should not undertake the work.

The EC Recommendation and the IFAC Code of Ethics offer a wide range of examples of safeguards dealing with a variety of circumstances in which threats might arise. But, as mentioned earlier, they are not intended to be comprehensive. In a modern, rapidly evolving business environment new threats to independence are constantly arising and new safeguards must be developed to address them. It is a major strength of the conceptual approach that it allows new circumstances to be dealt with without impossibly long lists of rules and without running the risk that ethical requirements will be evaded because the new circumstances do not precisely match any previously specified prohibitions.

## ***5. Nature and Purpose of the Proposed Considerations on Implementation of the Framework Approach***

This booklet aims to provide consideration on the application of the conceptual framework to auditor independence.

The booklet also seeks to help the auditor and others identify the potential threats to auditor independence and suggests thought processes that might be undertaken to identify safeguards which may be applied to eliminate or reduce them to an acceptable level. It also provides a detailed

comparison of the structure and content of the EC Recommendation and the IFAC Code of Ethics, and highlights significant differences.

The booklet does not aim to provide a “set of rules”. Its intention is to demonstrate how the underlying principles may be applied. The booklet aims to aid the thought process of the auditor faced with a situation which poses a threat to his objectivity and the possible safeguards that may be applied to mitigate such threats. The booklet does not provide any mandatory interpretation or guidance. It is intended to be a tool to help legislators, regulators, supervisors, civil servants, academics, students, practitioners and institutes understand how the framework approach works.

## ***6. Structure and Content***

As mentioned above, both the EC Recommendation and the independence section of the IFAC Code of Ethics adopt the same approach to safeguarding auditor independence, i.e. both use the same or at least similar terms and fundamental concepts. Both documents set out the conceptual framework approach and identify situations or relationships, which may create a threat to independence, and suggest the possible safeguards which can be put in place to mitigate the threats.

There is, nevertheless, a fundamental difference in the scope of each document. The EC Recommendation deals exclusively with statutory audit, due to the jurisdictional framework and concepts provided by the EU directives. The IFAC Code of Ethics, on the other hand, addresses all forms of assurance engagements (including audits). The Booklet, therefore, considers only the differences as they apply to statutory audits.

The IFAC Code of Ethics also makes a distinction based on the nature of the engagement: whether it is an audit or another kind of engagement, and in the case of an assurance engagement which is not an audit, the purpose, subject matter and intended users of the report. In those particular circumstances, the IFAC Code of Ethics recognises clearly that the threats that could arise and the safeguards that could be put in place to meet them are different.

It should also be noted that the IFAC Code of Ethics directly addresses some situations that, though they are covered by the principles of the EC Recommendation, are not explicitly referred to by the EC Recommendation such as: provision of taxation services to audit clients, provision of legal services to audit clients, corporate finance and similar activities.

The EC Recommendation applies additional requirements to “public interest entities” while the IFAC Code of Ethics applies additional requirements only to “listed entities”. The proposed Eighth Company Law directive on the statutory audit of annual accounts and consolidated accounts also uses the term “public interest entity”. The EC Recommendation and the proposed Eighth Company Law directive definition, detailed in the Glossary and Definitions in Appendix 1, therefore, includes entities that are not included in the IFAC Code of Ethics. However, the latter does discuss the advisability of applying the additional requirements to other entities of significant public interest.

Neither document makes any conceptual difference between “public and non-public interest entities” and “listed and non-listed entities” as defined by the EC Recommendation and IFAC Code of Ethics, respectively, but when they give examples of practical situations, there are some differences, particularly regarding the audit of “public interest entities” and “listed entities”. The evaluation of the significance of any threats to independence and the safeguards necessary to reduce any threats to an acceptable level, takes into account the public interest. Because of the strong public interest in the financial statements of “public interest entities” and “listed entities”, certain additional matters of perception are considered to be relevant to the audit of “public interest entities” and “listed entities”.

## CHAPTER 1 – FINANCIAL INTERESTS

### *1.1 Introduction*

An auditor's objectivity may be threatened or appear to be threatened as a consequence of financial interests in clients.

The EC Recommendation regarding financial interests requires that an auditor should not accept or continue an audit engagement if either the auditor, the audit firm or specified persons within it hold:

- Any direct financial interest in the audit client;
- Any indirect financial interest in the audit client which is significant to either party;
- Any (direct or indirect) financial interest in the audit client's affiliates (as defined in the Glossary and Definitions in Appendix 1) which is significant to either party.

In addition, any other person in the audit firm or its network who is in a position to influence the outcome of the audit, should not have significant financial interests.

The auditor will need to assess whether financial interests impact on his independence or objectivity in carrying out his responsibilities. The assessment of the relationship will be based on the knowledge and understanding of the auditor and the individual concerned and the auditor would need to implement appropriate safeguards to reduce or eliminate any threats to independence.

### *1.2 Comparison*

The IFAC Code of Ethics applies to all assurance engagements whereas the EC recommendation addresses only the statutory audit. The scope of the respective codes is, therefore, different. Accordingly, this chapter considers only the differences as they apply to the statutory audit.

A summary comparison is set out below:

#### *1.2.1 Threats*

In terms of the threats posed by financial interests, the IFAC Code of Ethics does not explicitly specify that an impending financial interest should be considered as well as an actual interest. This is not considered significant, as any such circumstance would be catered for by the framework approach.

#### *1.2.2 Definitions*

There are certain general definition differences between the documents in terms of who is covered. Subject to that, the scope is broadly similar for audit clients, though the IFAC Code of Ethics extends the requirements to providers of significant non-assurance services.

The apparent differences from use of the words 'significant' and 'material' are not considered significant (or material) in practice. Neither is the fact that the EC Recommendation requires "significant" to be considered from both parties' point of view. This follows from the framework approach.

The EC Recommendation does not directly refer to financial interests held by affiliates of the audit firm. The IFAC Code of Ethics would appear to be more stringent, but as the EC Recommendation's scope includes individuals from the audit firm and its network, who are in a position to exert influence on the audit, the effect is similar in substance.

The use in the IFAC Code of Ethics of "two tiers" of "family" results in a slightly different emphasis on the threat posed by financial interests of certain family members. To comply with both codes, it is advisable to extend the basic requirements which apply to immediate family members for all interests, and to close family members for significant interests. In addition, both the EC Recommendation and the IFAC Code of Ethics require the auditor to pay due regard to other, non-family relationships in assessing the threats posed by such relationships. This assessment will depend on the auditor's knowledge of the circumstances in relation to the audit client.

### ***1.2.3 Materiality***

The IFAC Code of Ethics specifically indicates that reducing a material indirect holding to an immaterial level is acceptable. However, this is not considered by the EC Recommendation. This is not considered significant as any such circumstance would be considered to be covered by the framework approach.

Similarly, the potential threat of insignificant holdings is not directly addressed by the IFAC Code of Ethics. Again, this is not considered significant as any such circumstance would be considered to be covered by the framework approach.

### ***1.2.4 Direct and Indirect Financial Interests***

The EC Recommendation's definition of financial interests is slightly broader than that in the IFAC Code of Ethics. However, this is not considered significant as any such circumstance would be considered to be covered by the framework approach.

Perhaps more noteworthy, is the difference in what interests are direct and what are indirect. The EC Recommendation focuses on the investment itself, irrespective of whether it is directly with the client or not. The IFAC Code of Ethics, on the other hand, is more concerned with the substance of whether the investment gives control or not. In practice, the answer would generally be the same, but there would be differences at the margins, which would give different answers in respect of holdings which are not material.

Despite the slightly different approaches to what constitutes direct and indirect interests, in substance, the EC Recommendation and the IFAC Code of Ethics reach the same conclusion regarding interests in entities with investments in clients, or in entities in which the client has investments, in respect of audit clients.

The approach regarding pension rights and plans is also different. The EC Recommendation considers pension rights with the client, whereas the IFAC Code of Ethics considers pension plans with investments in the client. Under a principles-based approach, any pension plan interest should be assessed under both criteria where relevant.

The safeguards considered in respect of non-beneficiary trustee auditors are also different and again, any such interest and therefore, safeguards, should be assessed under both criteria where relevant.

Unlike the EC Recommendation, the IFAC Code of Ethics does not specifically state that holdings through collective investment schemes are unlikely to be a threat where there is no direct involvement in auditing or decision making of the fund manager. It could, however, be considered that the IFAC Code of Ethics implies it through its discussion of the nature of the interest. The EC Recommendations' discussion follows logically from the framework approach.

The guidance on inadvertent violations is similar: disposal of the interest as soon as possible or removal of the individual from the engagement; possible discussion with those charged with governance and/or involvement of an independent reviewer. However, while the IFAC Code of Ethics does not prescribe any particular disposal period beyond 'at the earliest practical date', the EC Recommendation requires disposal within one month. In terms of audit engagements, therefore, this latter requirement should be followed to ensure compliance with both codes.

### ***1.3 Matters for Consideration by the Auditor***

#### ***1.3.1 Threats***

Financial interest in an audit client may cause "self-interest" or "intimidation threats".

##### ***1.3.1.1 Self-interest Threats***

A self-interest threat may arise by the auditor's desire to protect the value of an investment or a future interest cash flow, where these may be impaired by a qualified audit report or by any other action the auditor may be called upon to take in accordance with professional standards. When assessing a self-interest threat caused by financial interests, the auditor may find it helpful to ask the following questions.

###### ***1.3.1.1.1 Nature of Financial Interest***

Is the financial interest purely economic in nature or does it bring personal involvement in the audited entity? Does it imply indirect or direct ownership?

###### ***1.3.1.1.2 Amount***

What is the significance of the financial interest? This could be related to:

- The financial position of the auditor i.e. is the interest important to the auditor personally?
- The financial position of the client i.e. is the investment important for the funding of the entity, or is it immaterial to its operations?
- The general idea of "a large amount" i.e. many third parties base their conclusions on the financial position of the "average" person even though, in reality, the amount is not material to the auditor or to the client.

### *1.3.1.1.3 Individuals Involved*

How closely involved is the person with the financial interest involved in the audit? In practice, the guidance given in section A. “Framework” 2. “Responsibility and scope”<sup>2</sup> of the EC Recommendation will answer most questions in this area.

### *1.3.1.1.4 Duration of Interest*

Is the interest a long or short-term investment? Questions to be asked may include:

- Long-term: Does the investment imply, at least in appearance, a permanent financial connection between the auditor and the audited entity?
- Short-term: Would adverse capital market reactions to a qualified audit report, or to a revision of the financial statements, be detrimental to the present value of the auditor’s financial interest?

### *1.3.1.1.5 Self-interest related Prohibitions outside the Framework of the Conceptual Approach*

The EC Recommendation contains a number of prohibitions that apply regardless of the outcome of a principles-based analysis such as that above (see Appendix 1 - for example item 1.2).

### *1.3.1.2 Intimidation Threats*

An intimidation threat may arise where a client, facing the possibility of a qualified audit report or some other action the auditor may be called upon to take in accordance with professional standards, may threaten to terminate a favourable contract or to cause negative publicity about the auditor’s involvement. In assessing such a threat, the auditor will find it helpful to ask the following questions.

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<sup>2</sup> 1. It is the responsibility of the Statutory Auditor to ensure that the requirement for statutory auditors’ independence is complied with.  
 2. The independence requirement applies to:  
 (a) The Statutory Auditor himself; and  
 (b) Those who are in a position to influence the out come of the Statutory Audit.  
 3. Those in a position to influence the outcome of the Statutory Audit are:  
 (a) All persons who are directly involved in the Statutory Audit ( the Engagement Team), including  
 (i) The Audit Partners, audit managers and audit staff (the Audit Team);  
 (ii) Professional personnel from other disciplines involved in the audit engagement (e.g. lawyers, actuaries, taxation specialists, IT-specialists, treasury management specialists);  
 (iii) Those who provide quality control or direct oversight of the audit engagement;  
 (b) All persons, who form part of the Chain of Command for the Statutory Audit within the Audit Firm or within a Network of which the firm is a member;  
 (c) All persons within the Audit Firm or its Network who, due to any other circumstances, may be in a position to exert influence on the Statutory Audit.

#### *1.3.1.2.1 Nature of Financial Interest*

- Does the auditor have any doubt as to the legal validity and ethical soundness of the engagement?
- Does the engagement consist of standard transactions in the normal course of business (see also Chapter 2 - Business Relationships)?
- Has the threat been tested not only against the explicit prohibitions in the EC Recommendation but also by a thorough analysis of any self-interest threats?

#### *1.3.1.2.2 Transparency*

Is the financial interest known to interested parties?

### ***1.3.2 Safeguards***

The EC Recommendation prohibits most financial involvement in clients by statutory auditors, audit firms, members of the engagement team or the chain of command, or any partner in the firm or its network<sup>3</sup> who is working in an office which participates in a significant proportion of an audit engagement. In fact, the IFAC Code of Ethics extends most of these prohibitions to other assurance engagements covered.

In such cases, a principles-based analysis is normally not meaningful, and no safeguards would be considered to be adequate to mitigate the threats. However, there are two cases where safeguards may serve a purpose:

1. The financial interest is acquired as a result of an external event, such as inheritance;
2. This is an inadvertent violation of the EC Recommendation.

The EC Recommendation contains detailed guidance for the application of safeguards in such cases.

In other cases, when considering safeguards, the auditor will find it helpful to ask the following questions:

#### *1.3.2.1 Changing Staff Members*

- Does the new staff member in the audit team come from another organisational entity within a large office, or does he belong to a small office where staff members are close to each other in their daily work?
- Is the staff member removed permanently from the audit team or is he allowed to return, e.g. after his financial interest has been disposed of?

#### *1.3.2.2 Secondary Review of Audit Work*

Is the secondary review performed by a person without previous connections to the audit assignment?

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<sup>3</sup> See Footnote 19 on page 73.

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*1.3.2.3 Communicating the Auditor's Analysis of Threats related to Financial Interest to the Governance Body of the Client (safeguard against self-interest and intimidation)*

Is the position of the governance body in the national legislation strong enough to help strengthen any safeguards the auditor plans to use?

Note that transparency does not relieve the auditor from his ultimate responsibility for his and his firm's independence.

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## CHAPTER 2 – BUSINESS RELATIONSHIPS

### 2.1 Introduction

An auditor's objectivity may be threatened or appear to be threatened where there is a business relationship between the auditor, or others in a position to influence the audit, and the client or its management.

The EC Recommendation regarding business relationships requires that an auditor should not engage in such relationships unless they are in the normal course of business and at arms length, and insignificant (from the viewpoint of a reasonable and informed third party) in terms of the threat they pose to independence. In cases of doubt about the latter, this should be discussed with the governance body of the client.

Business relationships involve having a commercial or financial interest in common. They are quite widely defined and include, inter alia:

- Financial interests in joint ventures or entities with an investor/investee relationship with the client (see also considerations on Financial Interests in Chapter 1);
- Loans or guarantees, to or from the client;
- Providing services to senior management of the client in respect of personal interests;
- Receiving services from the client in respect of securities issued by the audit firm or its group.

It follows that, as specified in the EC Recommendation, the audit firm (including its network<sup>4</sup>) should not provide audit services to owners of the audit firm or an affiliate of such an owner where there is significant influence, or any other entity with senior management in a position to influence decision making of the audit function.

Similarly, and again as specified in the EC Recommendation, accepting goods or services from the client on favourable terms is not acceptable unless the value of the benefit is insignificant.

### 2.2 Comparison

The IFAC Code of Ethics on independence applies to all assurance engagements whereas the EC Recommendation addresses only the statutory audit. The scope, therefore, of the respective codes is different. Accordingly, this chapter considers only the differences as they apply to the statutory audit.

A summary comparison is set out below:

#### 2.2.1 Threats

The description of the threats posed by business relationships is similar, subject to the generic differences in the scope definitions.

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<sup>4</sup> See Footnote 19 on page 73.

### ***2.2.2 Underlying Requirement***

The EC Recommendation's prohibition is more restrictive: to be exempt from the prohibition in the IFAC Code of Ethics, the relationship needs to be immaterial and insignificant to the parties. To be exempt from the prohibition in the EC Recommendation, the relationship not only needs to be all the above, but also in the normal course of business.

The EC Recommendation clearly addresses current and committed business relationships. The latter are not directly considered by the IFAC Code of Ethics. However, this is not considered significant, as any such circumstance would be catered for by the framework approach.

### ***2.2.3 Provision of Services to Owners of the Audit Firm and other Parties in a Position to Influence***

This is only covered by the EC Recommendation. The guidance, however, is unclear as to who is an owner. The concept of significant influence is only referred to in relation to affiliates of owners and other parties. Clearly anyone with an ownership interest (share of, or other entitlements to, profit and / or voting rights) that is large enough to exercise significant influence is clearly covered, but for owners of lesser interests, the position is less clear. If there is no significant influence, the actual threat to independence from this source should be relatively low, but the perceived threat would need to be considered in such circumstances.

### ***2.2.4 Scope of Business Relationship***

In substance, the concept of business relationships is similar between the EC Recommendation and the IFAC Code of Ethics, though each quotes slightly different examples.

Notwithstanding that loans are dealt with in different sections (the IFAC Code of Ethics deals them under Chapter 1 - Financial Interests) the effective difference is the same as that between the business relationship prohibitions (an immaterial amount, outside the normal course of business would appear to be exempt from the prohibition in the IFAC Code of Ethics but not the prohibition in the EC Recommendation).

The IFAC Code of Ethics also covers accepting goods or services from clients on beneficial terms in a separate section (see comparison in Appendix 2). However the guidance provided by the two codes is similar.

Only the EC Recommendation explicitly includes within business relationships, services to senior management and the receipt of services from the client in respect of securities issued by the audit firm. This is not considered significant, as any such circumstance would be catered for by the framework approach.

## ***2.3 Matters for Consideration by the Auditor***

### ***2.3.1 Threats***

As business relationships with audit clients have a financial aspect, the independence characteristics are similar to financial interests. Thus they may cause "self-interest", "intimidation" or "familiarity threats".

### *2.3.1.1 Self-interest Threats*

A self-interest threat may be caused by the auditor's temptation to protect the actual or prospective financial benefit dependant on a joint venture or other business relationship, if these could be impaired by a qualified audit report or by any other action the auditor may be called upon to take in accordance with professional standards. The threats are similar in this respect to those incurred when holding financial interests. When assessing a self-interest threat caused by business relationships, the auditor will find it helpful to ask the following questions.

#### *2.3.1.1.1 Nature of Business Relationship*

Is the relationship at arms length and in the normal course of business? Could other parties be involved on similar terms?

#### *2.3.1.1.2 Amount*

How significant is the actual or potential benefit from the business relationship? The amount could be related to:

- The financial position of the auditor: Is the value of the relationship important to the auditor personally?
- The financial position of the client: Is the value of the relationship important for the operation of the entity?
- The perception of the business relationship: this may be seen to be influential even though the amount is actually unimportant to the auditor or to the client?

#### *2.3.1.1.3 Individuals Involved*

How close to the audit work is the individual involved? In practice, the guidance given in section A "Framework" 2. "Responsibility and scope" (see Footnote 1 on page 9) of the EC Recommendation will answer most questions in this area.

#### *2.3.1.1.4 Duration of Relationship*

Is the business relationship long or short-term? Questions to be asked may include:

- Long-term: Does the relationship imply, at least in appearance, a permanent financial connection between the auditor and the audited entity?
- Short-term: Would adverse capital market reactions to a qualified audit report, or to a restatement of the financial statements, be detrimental to the value of the business relationship to the auditor?

### *2.3.1.1.5 Other Issues*

It is important to bear in mind that the EC Recommendation starts with a presumption that business relationships should not be entered into unless it can be shown that various conditions apply, and that the threats are insignificant.

### *2.3.1.2 Intimidation Threats*

An intimidation threat may be caused by the auditor's perception that the client, facing the possibility of a qualified audit report or some other action the auditor may be called upon to take in accordance with professional standards, may threaten to terminate or adversely amend a favourable business relationship. When assessing an intimidation threat caused by business relationships, the auditor will find it helpful to ask the following questions.

#### *2.3.1.2.1 Nature of Business Relationship*

- Does the auditor have any doubt as to the legal validity and ethical soundness of the engagement?
- Does the engagement consist of standard transactions in the normal course of business and has it been tested not only against the explicit prohibitions in the Recommendation but also by a thorough analysis of any self-interest threats?

#### *2.3.1.2.2 Transparency*

Is any business relationship that may exist unknown to interested parties?

### *2.3.1.3 Familiarity Threats*

The business relationship may result in a close working or other relationship between the auditor and individuals at the client or others in a position to benefit from the client's performance. The auditor may find it helpful to consider:

#### *2.3.1.3.1 Nature of Business Relationship*

- Does the business relationship create or appear to create close working relationship with individuals at the client or others in a position to benefit from the client's performance?
- Does this create a sense of obligation?
- Individuals involved: How much are the individuals involved at the audit firm in a position to influence the audit?
- Self-Justification: Would others not involved in this relationship reach the same conclusions?

### 2.3.2 Safeguards

The EC Recommendation requires that an auditor should not enter into business relationships unless they are in the normal course of business and at arms length, and insignificant (from the viewpoint of a reasonable and informed third party) in terms of the threat they pose to independence. In such cases, a principles-based analysis is meaningful only where the relationship complies with all of the above conditions. The nature of permitted relationships may be such that no further safeguards are necessary. However, in borderline cases, additional safeguards may be necessary.

When considering safeguards, the auditor will find it helpful to ask the following questions:

#### 2.3.2.1 Changing Staff Members (where the relationship is with individuals in the audit firm, not the firm itself)

- Does the new staff member in the audit team come from a part of the organisation not involved with the business relationship, or does he belong to a small office where staff work closely in their day-to day work?
- Is the staff member removed permanently from the audit team or is he allowed to return, e.g. after the business relationship has been terminated?

#### 2.3.2.2 Secondary Review of Audit Work (where the relationship is with individuals in the audit firm or one office, not the firm itself)

Is the secondary review performed by a person without any direct or indirect involvement in the business relationship?

#### 2.3.2.3 Communicating the Auditor's Analysis of Threats related to Financial Interest to the Governance Body of the Client

Is the position of the governance body in the national legislation strong enough to help strengthen any safeguards the auditor plans to use?

It is worth bearing in mind that transparency, per se, does not relieve the auditor from his ultimate responsibility for his and his firm's independence.

## CHAPTER 3 – EMPLOYMENT WITH THE AUDIT CLIENT

### 3.1 Introduction

The different situations and circumstances concerning actual and potential employment with an audit client are considered in this chapter.

When an auditor is employed by an audit client or is to leave/may leave the firm to join an audit client, a reasonable and informed third party may perceive the statutory auditor's independence to be threatened.

The significance of the threat depends on the individuals' influence over the outcome of the audit engagement and his role at the client.

### 3.2 Comparison

The EC Recommendation addresses only the statutory audit whereas the IFAC Code of Ethics applies to all assurance engagements. The general scope, therefore, of the respective codes is different. Accordingly, this chapter considers only the differences as they apply to the statutory audit.

#### 3.2.1 Targeted Individuals

The requirements of the EC Recommendation apply to any individual who is in a position to influence the outcome of the statutory audit of the audit client or one of its affiliates. Thus, key audit partners as well as former audit team members or individuals within the chain of command leaving the audit firm to join the audit client for a key management position are subject to the requirements.

The requirements of the IFAC Code of Ethics apply to directors, officers or employees of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement who have been a member of the assurance team, partner or former partner of the firm. In addition, for audit clients, such individuals of network firms<sup>5</sup> are also included.

Thus, the targeted groups of individuals in the respective codes are principally the same.

#### 3.2.2 Threats

##### 3.2.2.1 Basic Threats

The basic threats considered in the two codes are similar.

The EC Recommendation highlights circumstances where threats to auditor independence may arise without pointing out the specific types of threats.

The EC Recommendation discusses five different situations which pose a threat to the auditor's independence:

<sup>5</sup> See Footnote 19 on page 73.

- Dual employment both at the audit firm and at the audit client;
- Loan staff assignments to an audit client;
- A member of the engagement team leaving the audit firm to join the audit client;
- A former member of the engagement team or chain of command joining the audit client;
- A key audit partner leaving the audit firm to join the audit client for a key management position.

The IFAC Code of Ethics deals with the incidence of “self-interest”, “self-review” and “familiarity threats” in three situations of employment with audit clients:

- A member of the assurance team, partner or former partner of the firm employed as a director, an officer or an employee of the client in a position to exert direct and significant influence over the subject matter of the engagement;
- A member of the assurance team who may leave to join the client in the future;
- Temporary staff assignments to audit clients.

### *3.2.2.2 Dual Employment*

In the EC Recommendation, the threats of dual employment relate to the assignee originating any accounting transaction or preparing original data that is not subject to client review and approval. In such circumstances, threats should be considered and safeguards applied.

Loan staff assignments are considered by the EC Recommendation to be dual employment relationships.

The IFAC Code of Ethics includes dual employment situations in the requirements regarding partners or employees in the audit firm serving as an officer or director on the board of assurance clients, which is dealt with in Chapter 4 - Managerial or Supervisory Role in Audit Client.

The threats relate to individuals making management decisions, approving or signing agreements and exercising discretionary authority committing the client. Again the threats should be considered and safeguards applied.

### *3.2.2.3 Future Employment*

The EC Recommendation explicitly deals with the situation of future employment where it is clearly decided that the person is to leave the audit firm.

The IFAC Code of Ethics also addresses the situation of future employment, but at a point where this is only considered a serious possibility.

### 3.2.3 Safeguards

Despite the similarity in the perceived threats, the safeguards suggested by the two codes differ, reflecting the difference in threat scenarios:

#### 3.2.3.1 Dual Employment and Loan Staff Agreements

The threats posed to the auditor's independence as a consequence of dual employment are such that the EC Recommendation prohibits such relationships.

The EC Recommendation nevertheless permits loan staff assignments with safeguards, even though they are regarded as dual employments.

The prohibitions in the EC Recommendation relate to the assignee not originating any accounting transaction or preparing original data that is not subject to client review and approval.

In the IFAC Code of Ethics, there are further prohibitions on making management decisions, approving or signing agreements and exercising discretionary authority committing the client.

Both require that the assignee, if he becomes part of the engagement team subsequently, should not be given any audit responsibility over any activity he performed while at the client.

#### 3.2.3.2. Engagement Team Member joining the Audit Client

The EC Recommendation requirement to apply safeguards when an individual is to leave the audit firm to join a client, is more specific and arguably more demanding than the IFAC Code of Ethics.

Where a former engagement team member or individual within the chain of command joins an audit client, the EC Recommendation requires the audit firm's policies and procedures to ensure that there are no significant connections between the firm and the individual. This includes settlement of all financial interests between them, unless pre-determined, and that the individual does not participate, or appear to do so, in the firm's business or activities.

The EC Recommendation includes a two-year cooling-off period. So where a key audit partner leaves the audit firm to join the audit client in a key management position, the risk is perceived as being unacceptably high, and therefore, a period of at least two years should elapse before the key audit partner can take up a key management position.

The IFAC Code of Ethics requires the application of safeguards when an individual may leave to join a client. The IFAC Code of Ethics does not make the independent review safeguard obligatory.

### ***3.3 Matters for Consideration by the Auditor***

Employment with the audit client may cause “self-interest”, “self-review” and “familiarity threats”.

The policies and procedures must be established in due consideration of continuing changes in the targeted groups of individuals as well as continuing changes in the client portfolio and engagements.

#### ***3.3.1 Threats***

The auditor should consider and identify the threats to independence. To that end, the auditor might find it helpful to ask the following questions:

- Are any individuals employed by the audit firm or its network firm’s members also employed by the audit client or any of its affiliates or part of any loan staff assignments with the client?
- Are any individuals employed by the audit firm or its network firm’s members going to leave / possibly going to leave to join the audit client or any of its affiliates?
- Are any former members of the engagement team or individuals in the chain of command joining the audit client?
- What position does the individual hold in the audit firm and/or with the client?
- What circumstances led to the departure?
- What length of time has elapsed since the individual left the audit firm?
- What length of time has elapsed since the individual in question performed services related to the audit engagement?

#### ***3.3.2 Safeguards***

To mitigate the threats to independence, the auditor should consider and apply appropriate safeguards.

##### ***3.3.2.1 Engagement Team Member joining the Audit Client***

Where a former member of the engagement team or an individual within the chain of command has joined an audit client, the audit firm’s policies and procedures should ensure that there no significant connection between itself and the individual. It should be considered what constitutes ‘pre-determined arrangements’ that cannot be influenced by any remaining connections, notably pensions and capital. Also, continuing profit related shares are not appropriate. Severing of connections would include:

- Settling of all capital balances and similar financial interests, unless made in accordance with pre-determined arrangements;
- Requiring the individual not participate or appear to participate in the firm’s business or professional activities.

##### ***3.3.2.2 Second Partner’s Review***

A period of at least two years should have elapsed before a key audit partner can take up a key management position with the client. If the key audit partner joins the audit client before this period has elapsed, the audit firm’s should cease to act or not accept the audit assignment.

In cases where the departing individual is a key audit partner, another audit partner should perform a review. The review should consider amongst other things:

- The possibility of undue influence exerted on the former partner during the previous year's audit;
- The former partner's relationship with the other audit team members;
- The possibility of the former partner using his knowledge to circumvent the current audit approach and testing strategy.

Appropriate safeguards should be adopted, including not giving individuals audit responsibility for those areas covered under a loan staff assignment.

### *3.3.2.3 Future Employment*

Where a member of the audit team is to leave the audit firm to join an audit client, policies and procedures should require:

- Immediate notification to the firm of the potential conflict;
- Immediate removal from the audit engagement;
- Immediate review of the audit work performed by the individual in question.

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## CHAPTER 4 – MANAGERIAL OR SUPERVISORY ROLE IN AUDIT CLIENT

### *4.1 Introduction*

The different situations and circumstances where the auditor takes a managerial or supervisory role in an audit client are discussed in this chapter.

When an auditor takes on a managerial or supervisory role in an audit client or serves as an officer or director on the board of an assurance client, a reasonable and informed third party may perceive the statutory auditor's independence to be threatened.

Furthermore, threats may be created by former partners or employees of the audit firm who take on such a role.

The significance of the threat depends on the individuals' influence over the outcome of the engagement and their role at the client.

### *4.2 Comparison*

The EC Recommendation addresses only the statutory audit whereas the IFAC Code of Ethics on independence applies to all assurance engagements. The scope, therefore, of the respective codes is different. Accordingly, this chapter considers only the differences as they apply to the statutory audit.

#### *4.2.1 Targeted Individuals*

The requirements of the EC Recommendation apply to any individual who is in a position to influence the outcome of the statutory audit. They also apply to former members of the engagement team. Further, the EC Recommendation considers only, the membership of any managerial or supervisory body of an audit client.

The requirements of the IFAC Code of Ethics apply to all partners and employees of the firm (and for audit clients also individuals in network firms<sup>6</sup>), irrespective of whether they are members of the assurance team or not. They also apply to former members of the assurance team. The IFAC Code of Ethics also considers those individuals serving as an officer (including a director) in an audit client.

Thus, the targeted group of individuals in the IFAC Code of Ethics appears to be wider.

#### *4.2.2 Threats*

The examples of circumstances considered by the two codes are similar. However, the types of threats mentioned differ.

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<sup>6</sup> See Footnote 19 on page 73.

#### *4.2.2.1 Self-interest, Self-review, Familiarity and Intimidation Threats*

##### *4.2.2.1.1 Managerial or Supervisory Role in Audit Client*

The EC Recommendation identifies that intimidation and self-review threats arise when a member of the engagement team:

- Becomes a member of any managerial or supervisory body of an audit client;
- Becomes a member of a managerial or supervisory body of an entity which holds directly or indirectly more than 20 percent of the voting rights in the client, or in which the client holds directly or indirectly more than 20 percent of the voting rights.

Thus, the EC Recommendation puts the emphasis on the ability to influence the outcome of the statutory audit and includes considerations of the relationship between the audit client and other entities.

In the IFAC Code of Ethics self-review, self-interest, intimidation and familiarity threats are said to arise when a partner or employee in the firm serves as an officer or director of the assurance client.

Thus, the IFAC Code of Ethics centers on the role (officer or director) itself but does not consider the relationship between the client and other entities.

The EC Recommendation contains further guidance where national law requires members of the audit profession to undertake supervisory roles in certain companies. The IFAC Code of Ethics, on the other hand does not explicitly address this.

The IFAC Code of Ethics contains further guidance on situations where a partner or employee serves as a company secretary. The EC Recommendation does not cover this aspect.

##### *4.2.2.1.2 Former Member of the Engagement Team Assumes a Managerial or Supervisory Role in Audit Client*

The EC Recommendation addresses threats that arise when a former member of the engagement team takes a managerial or supervisory role in an audit client. The IFAC Code of Ethics addresses threats when a former member of the team takes on a role as an officer or director of the client.

### **4.2.3 Safeguards**

As there are some differences in the threat scenarios described in the two codes, there are also differences in the safeguards to be applied.

##### *4.2.3.1 Managerial or Supervisory Role in Audit Client*

The EC Recommendation includes prohibitions for individuals who:

- Become a member of any managerial or supervisory body of an audit client; or
- Become a member of a managerial or supervisory body of an entity which holds directly or indirectly more than 20 percent of the voting rights in the client, or in which the client holds directly or indirectly more than 20 percent of the voting rights.

The IFAC Code of Ethics prohibits partners or employees of the firm from serving as an officer or a director on the board of the assurance client. In cases of audit engagements, the prohibition is extended to such persons in network firms.

The EC Recommendation caters for circumstances where national law requires members of the audit profession to undertake supervisory roles in certain companies. In such cases, it nevertheless requires safeguards to be implemented to ensure that such individuals do not have any responsibility with regard to the engagement team.

Generally, a partner or employee of the audit firm or the network firm is prohibited from serving as a company secretary for an audit client. Assistance may however, be provided for routine and formal administrative duties and functions if specifically permitted under national law, professional rules or practice and provided that the client's management makes all relevant decisions.

#### *4.2.3.2 Former Member of the Engagement Team Assumes a Managerial or Supervisory Role in Audit Client*

The EC Recommendation requires safeguards to be applied when a former member of the engagement team joins the audit client in a managerial or supervisory role. Thus, policies and procedures of the audit firm should ensure that there are no significant connections between the firm and the individual. Further, in the case of a key audit partner, at least two years should elapse before taking up such a position.

### **4.3 Matters for Consideration by the Auditor**

An auditor having a managerial or supervisory role in an audit client gives rise to “self-review”, “self-interest”, “intimidation” and “familiarity” threats.

The policies and procedures must be established in due consideration of continuing changes in the targeted groups of individuals and continuing changes in the client portfolio and engagements as well as changes in the role played by the individual with the client.

#### **4.3.1 Threats**

##### *4.3.1.1 Self-interest, Self-review, Familiarity and Intimidation Threats*

###### *4.3.1.1.1 Managerial or Supervisory Role in Audit Client*

The auditor should consider and identify the threats to independence. To that end, the auditor might find it helpful to consider the following questions:

- Does any partner or employee in the firm serve as an officer or director of an audit client?
- Does any partner or employee in the audit firm or network firm serve as an officer or director in the audit client?
- Does the statutory auditor or any person, who is in a position to influence the outcome of the statutory audit, have a managerial or supervisory role in the audit client?

- Does the statutory auditor or any person, who is in a position to influence the outcome of the statutory audit, have a managerial or supervisory role in an entity that holds directly or indirectly more than 20 percent of the voting rights in the client?
- Does the statutory auditor or any person, who is in a position to influence the outcome of the statutory audit, have a managerial or supervisory role in an entity in which the client holds directly or indirectly more than 20 percent of the voting rights?

Where national law requires members of the audit profession to undertake supervisory roles in certain companies:

- Does the individual have any responsibility with regard to the engagement team?

Where a partner or employee of the audit firm or a network firm serves as a company secretary for an audit client:

- Is the practice specifically permitted under national law, rules or practice?
- Are the duties and functions undertaken limited to those of a routine and formal administrative nature implying that client management makes all relevant decisions?

#### *4.3.1.1.2 Former Member of the Engagement Team Assumes a Managerial or Supervisory Role in an Audit Client*

If a former member of the engagement team takes a managerial or supervisory role in an audit client, there is a threat to the statutory auditor's independence. When assessing this threat, the auditor might find it helpful to ask the following question:

- Has any person, who now has a managerial or supervisory role in the client, been a member of the engagement team?

### **4.3.2 Safeguards**

To mitigate the threats to independence, the auditor should consider and apply appropriate safeguards including prohibitions where necessary.

#### *4.3.2.1 Prohibitions*

If a member of the engagement team or any other individual who is employed in the audit firm takes a managerial or supervisory role in an audit client, the threat to independence is unacceptably high. Accordingly, the EC Recommendation requires that members of the audit firm should not take up such positions.

The IFAC Code of Ethics extends these prohibitions to a wider group of persons in the audit firm or network firm and to a wider group of duties and functions with the client.

The EC Recommendation also requires the relationship between the audit client and other entities to be considered in this respect.

#### *4.3.2.2 Other Safeguards*

In situations where a threat has been identified, the auditor should consider the need to apply safeguards. In order to make sure that all such circumstances are identified, the auditor might find it helpful to consider the following question:

- Do the firm's policies and procedures give clear and sufficient guidance for all persons on how to identify, assess and report situations that might cause a threat to independence?

## CHAPTER 5 – ESTABLISHING EMPLOYMENT WITH AUDIT FIRM

### 5.1 Introduction

This chapter discusses the threats posed in relation to establishing employment with audit firm (EC Recommendation) and recent services with assurance clients (IFAC Code of Ethics).

When a former director, officer, manager or employee of an audit client joins the audit firm, a reasonable and informed third party may perceive the statutory auditor's independence to be threatened.

The significance of the threat depends on the individual's past influence on the subject matter of the engagement and the individual's influence over the outcome of the statutory audit work having become an employee of the audit firm.

### 5.2 Comparison

The EC Recommendation addresses only the statutory audit whereas the IFAC Code of Ethics on independence applies to all assurance engagements. The scope, therefore, of the respective codes is different. Accordingly, this chapter considers only differences as they apply to the statutory audit.

#### 5.2.1 Targeted Individuals

The requirements of the EC Recommendation apply to former directors or managers of the audit client and to former employees of the audit client depending on the significance of their responsibilities and tasks in relation to the statutory audit function.

The requirements of the IFAC Code of Ethics apply to former officers or directors of the assurance client and to former employees of the assurance client depending on their position and ability to exert influence over the subject matter of the assurance engagement.

The EC Recommendation requirements are aimed at those individuals who become members of the engagement team of the audit client or members of the chain of command of the audit firm. By definition this includes employed as well as subcontracted professionals (lawyers, actuaries etc).

The IFAC Code of Ethics requirements focus on those individuals who become members of the assurance team, but include all within the firm who can directly influence the outcome of the engagement. For audit clients this will also include all those within network firms<sup>7</sup> who can directly influence the outcome of the audit engagement.

In summary, the two codes seek to target the same groups of individuals. It should be borne in mind that to comply with both codes, network firms should be considered as noted above.

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<sup>7</sup> See Footnote 19 on page 73.

## 5.2.2 Threats

The examples of circumstances that pose a threat to independence considered in the two codes are similar. The IFAC Code of Ethics considers the possibility of a wider range of threats than the EC Code, but comes to similar conclusions.

### 5.2.2.1 Self-review Threats

The EC Recommendation identifies that a self-review threat arises when a former director, manager or employee of the audit client becomes a member of the engagement team of the audit client or a member of the chain of command of the audit firm.

The significance of the threat will depend on the position, responsibilities and tasks this individual had at the audit client and those the same individual is to assume at the audit firm. Further, the significance of the threat will also depend on the period of time that has lapsed since leaving the audit client.

### 5.2.2.2 Self-interest, Self-review and Familiarity Threats

The IFAC Code of Ethics addresses the incidence of “self-review”, “self-interest” and “familiarity” threats when a former officer, director or employee of an assurance client becomes a member of the assurance team.

The significance of these threats will depend on the position, responsibilities and tasks this individual had at the assurance client and those the same individual is to assume at the audit firm.

Further, the significance of the threats is also considered to take into account whether the individual served at the client prior to or during the period covered by the audit report. Thus, the possible influence on specific disclosures covered by the audit report are the focus of attention.

## 5.2.3 Safeguards

Despite the basic similarity in threat scenarios, the safeguards required by the two codes differ in some respects.

### 5.2.3.1 Prohibition on Becoming a Member of the Engagement Team

The EC Recommendation prohibits the following individuals from becoming a member of the engagement team:

- A former director or manager of the audit client;
- A former employee of the audit client, if the responsibilities and tasks the individual had at the audit client were significant in relation to the statutory audit;
- At any time in the two year period after leaving the audit client.

The prohibitions regarding former directors or managers appear to be connected to their function and irrespective of the specific responsibilities and tasks the individual had at the audit client.

The prohibitions regarding former employees depend on the significance of the responsibilities and tasks. The significance should be evaluated in relation to the statutory audit function in general, and not specifically to the statutory audit opinion or report.

The IFAC Code of Ethics prohibits a former officer, director or employee from becoming a member of the assurance team:

- If he had been in a position to exert direct and significant influence over the subject matter of the assurance engagement; and
- If they served at the assurance client *during* the period covered by the assurance report.

#### 5.2.3.2 Prohibition on Taking Part in any Substantive Decisions

In the EC Recommendation, the following individuals are prohibited from taking part in any substantive decisions concerning the audit assignment with this client or with one of the client's affiliates:

- A former director or manager who joins the chain of command of the audit firm;
- A former employee of the audit client who joins the chain of command of the audit firm, if the responsibilities and tasks the individual had at the audit client were significant in relation to the statutory audit at any time in the two year period after leaving the audit client.

The two-year cooling-off period is the only safeguard required.

The IFAC Code of Ethics requires other safeguards to be considered and applied regarding a former officer, director or employee:

- If he had been in a position to exert direct and significant influence over the subject matter of the engagement; and
- If he served at the client *prior to* the period covered by the audit report; and
- Unless the threat is clearly insignificant.

Thus, in any case threats have to be evaluated according to the IFAC Code of Ethics, and other safeguards are required.

Such safeguards might include:

- Involving an additional professional accountant;
- Discussing the issue with those charged with governance.

As far as the IFAC Code of Ethics is concerned, the 'client' does not explicitly include the client-related entities and affiliates. However, following the definition of an audit client, "client" does include related entities if the audit client is a listed entity.

### ***5.3 Matters for Consideration by the Auditor***

A former director, officer, manager or employee of an audit or assurance client establishing employment with the audit firm may give rise to “self-review”, “self-interest” and “familiarity” threats.

The policies and procedures must be established in due consideration of continuing changes in the targeted groups of individuals as well as continuing changes in the client portfolio and engagements.

#### ***5.3.1 Threats***

The auditor should consider and identify the threats to independence. To that end, the auditor might find it helpful to ask the following questions:

- Are any members of the team (including those in the chain of command) a former director, manager or employee of the audit client?
- What position did the individual hold with the client and to what extent was he in a position to exert direct and significant influence on the subject matter of the audit report?
- How much time has lapsed since the individual left the client?
- Did the individual serve at the client prior to, or during the period covered by the audit report? If prior: were the threats created clearly insignificant?

#### ***5.3.2 Safeguards***

To mitigate the threats, the auditor should consider and apply appropriate safeguards including prohibitions.

The two-year cooling-off period is the only safeguard required by the EC Recommendation.

The IFAC Code of Ethics includes prohibitions but also other safeguards to mitigate identified threats to an acceptable level.

By focusing on the individual’s past ability to exert influence on the subject matter of the assurance assignment, irrespective of the time passed since the individual left the client, the IFAC Code of Ethics considers the possibility of threats arising over a longer period of time.

In assessing the significance of the threats, the auditor might find it helpful to ask the following questions:

- Which position did the individual hold with the client?
- How much time has passed since the individual left the client?
- Which role did the individual play on the team?

## **CHAPTER 6 – FAMILY AND OTHER PERSONAL RELATIONSHIPS**

### ***6.1 Introduction***

An auditor's objectivity may be threatened or appear to be threatened as a consequence of family or other personal relationships.

The EC Recommendation regarding family and other personal relationships requires that an auditor should not accept or continue an audit engagement if someone closely connected to him:

- Holds a senior management position with the client;
- Is in a position to exert direct influence on the preparation of the accounting records or financial statements;
- Has a financial interest in the client unless it is insignificant (see Chapter 1 - Financial Interests);
- Has a business relationship with the client unless it is in the normal course of business and is insignificant (see Chapter 2 - Business Relationships).

The above criteria apply to all members of the audit team and to the firm as a whole. The auditor will need to assess whether family and other personal relationships impact on his independence or objectivity in carrying out his responsibilities. The assessment of the relationship will be based on the knowledge and understanding of the auditor and the individual concerned and the auditor would need to implement appropriate safeguards to reduce or eliminate any threats to independence.

### ***6.2 Comparison***

The IFAC Code of Ethics applies to all assurance engagements whereas the EC Recommendation addresses only the statutory audit. The scope, therefore, of the respective codes is different. Accordingly, the scope of this chapter is to consider only the differences that apply insofar as statutory audits are concerned.

#### ***6.2.1 Threats***

The threats considered by the EC Recommendation and the IFAC Code of Ethics regarding family and other personal relationships focus on the ability of such individuals to influence the audit. The identified threats therefore are comparable with no significant differences.

#### ***6.2.2 Safeguards***

The safeguards considered by both the EC Recommendation and the IFAC Code of Ethics are comparable with no significant differences.

### **6.2.3 Definitions**

The persons covered by the EC Recommendation and the IFAC Code of Ethics definitions are comparable with no significant differences. However, the use in the IFAC Code of Ethics of “two tiers” of “family” results in a slightly different emphasis on the threat posed by certain family members. To comply with both codes, it is advisable to extend the basic requirements which apply to immediate family members to close family members. In addition, both the EC Recommendation and the IFAC Code of Ethics require the auditor to pay due regard to other, non-family relationships in assessing the threats posed by such relationships. This assessment will depend on the auditor’s knowledge of the circumstances in relation to the audit client.

### **6.2.4 Inadvertent Violations**

Both the EC Recommendation and the IFAC Code of Ethics cater for inadvertent violations. The suggested safeguards are comparable with no significant differences.

## **6.3 Matters for Consideration by the Auditor**

### **6.3.1 Threats**

Family and other personal relationships may give rise to “self-interest”, “familiarity”, and/or “intimidation” threats.

#### **6.3.1.1 Self-interest Threats**

The nature of a self-interest threat may be perceived as a wish on the auditor’s part to maintain good relations with family members and other personal contacts. A qualified audit report or any other action the auditor may be called upon to take in accordance with professional standards may affect these relationships.

#### **6.3.1.2 Familiarity Threats**

The nature of a familiarity threat may be perceived as the auditor being too trusting because of a family or other personal relationships thus resulting in insufficient testing of representations made.

#### **6.3.1.3 Intimidation Threats**

The nature of an intimidation threat may be perceived as the auditor being influenced and/or deterred from acting objectively and exercising professional scepticism by threats, actual or perceived by members of the family or other personal contacts. Such threats may be brought to bear by a domineering or overbearing personality.

#### 6.3.1.4 *The Significance of the Threats*

When assessing the threats, the auditor may find it helpful to assess the significance of the relationships. Therefore, in evaluating the significance of these threats, the auditor should consider asking the following questions:

- What are the individual's responsibilities on the audit?
- Is the closeness of the relationship between the auditor and the client a factor?
- How important is it to the auditor to maintain good relations and how will this be viewed by reasonable and informed third parties?
- What is the role of the individual within the audit client?
- What is the overall audit environment?

#### 6.3.2 *Safeguards*

There is a wide spectrum of circumstances, which need to be evaluated in assessing the threats posed as a consequence of family or other personal relationships. Once identified, the auditor would then need to consider the effectiveness of the available safeguards in eliminating these threats or in reducing them to an acceptable level.

In certain situations (as set out in 6.1 above), the EC Recommendation requires that the nature of the relationship is such that the only appropriate safeguard is for the auditor not to accept (or continue) the appointment.

In other cases, to counter threats to independence as a consequence of family and other personal relationships, the safeguards that may be applied include:

- Removal of the individual from the audit team. A safeguard such as the removal of the individual from the audit team and excluding that individual from the decision making process regarding the client may be appropriate where a director or senior employee of an audit client is closely connected with a partner or a member of the audit team. Such situations will give rise to real fears of a lack of independence.
- Ensuring the member of the audit team does not deal with matters that are within the responsibility of the related individual (in the audit client) who is closely connected to him. Where a family or other personal relationship is discovered during the course of the audit, particular care should be taken to review the work undertaken by this individual and to take appropriate steps for the conclusion of the audit.

Such a safeguard may be appropriate where a close family member holding a senior management position or is able to exert direct influence on the preparation of accounting records or financial statements. In such cases safeguards would include excluding that individual from the decision making process regarding the client, removing the individual from the audit team and ensuring that the work undertaken by the individual concerned is carefully reviewed by another senior audit partner (or external consultant).

In some cases the violation may be discovered during the audit. Where this is the case appropriate safeguards need to be implemented to counter the threats that may arise. Again in such cases the safeguards available to the auditor include review of the work undertaken by the individual concerned, the removal of that individual from the audit team and excluding the individual from the decision making process.

- The audit firm's policies and procedures requiring employees to disclose whether a family or other personal relationship may pose a risk to independence and to regularly confirm the details.

An individual who has a financial interest in an audit client and who is closely connected with a partner or a member of the audit team, will pose a threat to independence unless it is insignificant. Similarly, where a spouse of a partner holds shares in an audit client and this holding is significant, this too will pose a threat to independence. To counter such threats, the firm should have in place procedures requiring the individual to disclose such circumstances where known. Additionally, the audit firm will need to ensure that the individual concerned is not involved in the audit or the decision making process to safeguard the firm's independence.

- Establishing adequate review procedures, including an annual review by the engagement partner and a partner (or external consultant) unconnected with the engagement, to safeguard against the loss of independence.
- Declining the appointment or ceasing to act if an on-going appointment.

The auditor should keep records of all reviews that have been carried out to identify any threats to independence, the safeguards implemented and reasons thereof.

The EC Recommendation recognises (as does the IFAC Code of Ethics) the possibility of inadvertent violations. These may occur when for example an individual fails to report a relationship that may be seen to compromise independence. Similarly, where a member of the audit team inherits shares in an audit client and it is a significant holding, this could violate the auditor's independence.

The auditor will need to ensure that as soon as he becomes aware of the default appropriate safeguards are implemented to counter the threats to independence.

In such cases, the auditor's independence is not regarded as being impaired if procedures are in place that require:

- Family and other personal relationships to be reported promptly;
- The prompt removal of the individual from the audit team;
- The individual to be excluded from the substantive decision-making process regarding the audit;
- Careful review of the work undertaken by the individual;
- The individual to dispose of the shares at the earliest opportunity but ensuring that this does not raise issues of insider dealing.

Family and other personal relationships may threaten or appear to threaten the auditor's independence. In all cases it would be necessary to assess the adequacy of the safeguards implemented and if real fears still exist regarding the loss of independence, then the appointment should be declined or terminated.

## CHAPTER 7 – NON-AUDIT SERVICES

### 7.1 Introduction

An auditor's independence may be threatened as a consequence of providing non-audit services to an audit client.

The EC Recommendation requires that, the statutory auditor, in the provision of non-audit services should avoid making any management decisions on behalf of the audit client. It also requires the statutory auditor to ensure that any remaining independence risk is eliminated or reduced to an acceptable level.

The IFAC Code of Ethics, acknowledges the mutual benefits that are derived from the assurance team obtaining information regarding the assurance client's business and operations. It nevertheless requires an evaluation of the significance of any threat to independence and that these threats be eliminated or reduced by the application of safeguards, where this is possible. The IFAC Code of Ethics also notes that in some cases no safeguards are available to reduce the threat to an acceptable level. For example, the IFAC Code of Ethics effectively prohibits auditors from making management decisions for assurance clients.

### 7.2 Comparison

The IFAC Code of Ethics applies to all assurance engagements whereas the EC recommendation addresses only the statutory audit. The scope, therefore, of the respective codes is different. Accordingly, this chapter considers only the differences as they apply to the statutory audit.

A summary comparison is set out below.

#### 7.2.1 Threats and Safeguards

##### 7.2.1.1 General

Both documents provide several examples of specific situations where the provision of non-audit services to an audit client would create a significant threat to the statutory auditor's independence. The examples should not, however, be taken to be an exhaustive list. The range of safeguards to mitigate the risk suggested by the respective codes is comparable on a situation-by-situation basis with no significant differences.

The EC Recommendation covers non-audit services to audit clients whereas the IFAC Code of Ethics covers non-assurance services to assurance clients, which implies that the scope of the IFAC Code is broader. Insofar as audit clients are concerned, the IFAC Code of Ethics includes restrictions in the provision of the following services:

- Preparation of accounting records and financial statements;
- Provision of valuation services;
- Provision of internal audit services;
- Provision of IT systems services;
- Temporary staff assignments;
- Provision of litigation support services;

- Provision of legal services;
- Recruiting of senior management;
- Provision of corporate finance services.

The following examples of non-audit services that may pose a threat to independence are considered explicitly by IFAC Code of Ethics but are not explicitly referred to by the EC Recommendation. However, application of the principles in the EC Recommendation would result in similar considerations concerning these services.

- Provision of taxation services to audit clients;
- Corporate finance and similar activities;
- Provision of legal services to audit clients (see 7.2.1.6. for the provision of legal services in connection with “Acting for the Client in the Resolution of Litigation”).

In addition, the IFAC Code of Ethics covers “Temporary staff assignments to audit clients”, which is not mentioned in this part of the EC Recommendation but is covered in Chapter 3 - Employment with the Audit Client.

Various other headlines differ without material consequences.

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

Both documents make no general distinction between “public interest and non-public interest clients” (EC Recommendation) and “listed and non-listed clients” (IFAC Code of Ethics). However, in regard to “preparing accounting records and financial statements”, in both the EC Recommendation and the IFAC Code of Ethics, there is a distinction.

The main difference between the two documents relates to the assessment of the assistance in the preparation process which is of solely technical/mechanical/informative/routine nature as far as “public interest entities” are concerned. Such assistance is prohibited by the EC Recommendation but allowed by the IFAC Code of Ethics for public interest entities other than listed entities and for divisions and subsidiaries of listed companies provided certain conditions are met.

The following table illustrates the differences:

Preparing Accounting Records and Financial Statements

Nature of Assistance Audit Client	Within the Statutory Audit Mandate		Solely of technical/mechanical/ informative/routine nature		All others	
	EC	IFAC	EC	IFAC	EC	IFAC
Listed Entity <sup>8</sup>	Allowed	Allowed	Prohibited	Allowed to collectively immaterial divisions and subsidiaries (provided certain conditions are met)	Prohibited (except: emergency situations)	Prohibited (except: emergency situations provided certain conditions are met)
Public Interest Entity other than Listed Entity <sup>9</sup>	Allowed	Allowed	Prohibited	Allowed	Prohibited (except: emergency situations)	Prohibited (except: emergency situations provided certain conditions are met)
Non-Public Interest Entity / Unlisted Entity <sup>10</sup>	Allowed	Allowed	Allowed	Allowed	Prohibited (except: emergency situations)	Prohibited (except: emergency situations provided certain conditions are met)

<sup>8</sup> Public Interest Entity under the EC Recommendation and Listed Entity under the IFAC Code of Ethics.

<sup>9</sup> Public Interest Entity under the EC Recommendation and Listed Entity under the IFAC Code of Ethics.

<sup>10</sup> Non-Public Interest Entity under the EC Recommendation and Unlisted Entity under the IFAC Code of Ethics.

### 7.2.1.3 Design and Implementation of Financial Information Technology Systems (FITS)

The nature of FITS services described in both documents is essentially similar. At first glance, the wording of the EC Recommendation is slightly stricter and more detailed than the IFAC Code of Ethics. Compared to the EC Recommendation, the IFAC Code of Ethics does not address the case in which FITS services would constitute a “turn key” project.

The provision of services in connection with the assessment, design and implementation of internal accounting controls and risk management controls are – provided certain conditions are met – not considered to pose a threat to independence in either document.

With regard to the significance of the independence risk in the case of a design project, the EC Recommendation makes reference to the size of the client whereas the IFAC Code of Ethics does not.

Furthermore, the EC Recommendation emphasises that the independence of a statutory auditor providing a review of alternative systems will be compromised when he has a significant financial interest in or a significant business relationship with any of the systems suppliers.

### 7.2.1.4 Valuation Services

Both codes require the prohibition of valuation services where they would lead to the valuation of amounts that are material in relation to the financial statements *and* where the valuation involves a significant degree of subjectivity. The requirements are comparable.

In cases which are not prohibited, the IFAC Code of Ethics suggests a range of safeguards whereas the EC Recommendation focuses on the fact that a valuation service should only be provided by an expert team with different personnel (incl. engagement partner) and different reporting lines to those of the audit engagement team.

The EC Recommendation explicitly excludes engagements to review or to issue an opinion on the valuation work performed by others or to collect and verify data to be used in a valuation performed by others (e.g. typical due diligence work in connection with the sale or purchase of a business).

According to the IFAC Code of Ethics valuation services to audit clients for tax purposes will not create a significant threat to independence because such valuations are generally subject to external review by a tax authority.

The following table illustrates the differences:

Nature of valuation services Code	Material to financial statements and significant degree of subjectivity	Not material to financial statements or no significant degree of subjectivity	Routine valuations	For tax purposes
<b>EC</b>	Prohibited	Allowed, provided certain safeguards are applied	Allowed	Not mentioned
<b>IFAC</b>	Prohibited	Allowed, provided certain safeguards are applied	Not mentioned	Allowed

#### 7.2.1.5 Participation in the Audit Client's Internal Audit

Both codes emphasise the responsibility of the audit client in the context of provision of internal audit services. The EC Recommendation is more explicit than the IFAC Code of Ethics as unlike the IFAC Code of Ethics, the EC Recommendation states very clearly that if the statutory auditor is not satisfied that the audit client's management acknowledge their responsibilities for internal controls, he should not participate in the audit client's internal audit.

Furthermore, the EC Recommendation requires an adequate review of the results of internal auditing processes for statutory audit purposes.

#### 7.2.1.6 Acting for the Client in the Resolution of Litigation

The EC Recommendation considers only the case in which an auditor is acting for the audit client in the resolution of litigation whereas the IFAC Code of Ethics additionally deals with the provision of legal services to audit clients.

Both codes prohibit the provision of litigation support services to audit clients if there is a material impact on the client's financial statements *and* a significant degree of subjectivity is inherent in the case concerned.

As regards taxation services, the IFAC Code of Ethics states explicitly that:

- Taxation services comprise a broad range of services, where assistance in the resolution of disputes is (only) one;
- Such assignments are generally not seen to create threats to independence.

The EC Recommendation mentions that even when taking a relatively active role on behalf of the client, there can be other specific situations which are generally not viewed as compromising a statutory auditor's independence and that such situations could include the representation of an audit client before the court or the tax administration authorities in the case of tax litigation.

### *7.2.1.7 Recruiting Senior Management*

The IFAC Code of Ethics generally allows a firm to provide services such as reviewing the professional qualification of a number of applicants and providing advice as to their suitability for the post. In addition, it allows the firm to produce a short-list of candidates for interview, provided it has been drawn up using criteria specified by the assurance client.

By contrast, the EC Recommendation makes a two-fold distinction:

- It distinguishes between the recruitment of senior staff in general, and the recruitment of staff for key financial and administration posts; in the latter case there might be circumstances where even the provision of a list of potential candidates for such posts may cause an unacceptable level of risk to independence.
- Furthermore, a distinction is made between statutory audits of public interest entities and non-public interest entities. Insofar as statutory audits of public interest entities are concerned, the independence risk would be perceived as too high to allow the provision of such a list by the auditor.

## *7.3 Matters for Consideration by the Auditor*

The IFAC Code of Ethics clearly states that a firm may provide services beyond the assurance engagement provided any threats to independence have been reduced to an acceptable level. Such a clear statement saying that, in principle, it is acceptable for auditors to provide non-audit services to audit clients is not present in the EC Recommendation.

### *7.3.1 Threats*

Providing non-audit services to an audit client may give rise to threats to independence; “self-review” threats, “self-interest” threats and “advocacy” threats. When assessing these threats, the auditor may find it helpful to ask the following questions:

- Is the statutory auditor involved in the decision-making process and is he aware of a self-review threat?
- Has the significance of any threat created by the provision of non-audit services been carefully evaluated?
- Is the auditor aware of the activities that would generally create self-interest or self-review threats that are so significant that only avoidance of the activity or refusal to perform the engagement would constitute reduction of the threats to an acceptable level?
- Does the statutory auditor participate in the preparation of the audit client’s accounting records or financial statements and is he aware of the significance of the self-review threat?
- Does the auditor provide services that involve the design and implementation of financial information technology systems (FITS) used to generate information forming part of the audit client’s financial statements and is he aware of the self-review threat?
- Are internal audit services provided to the audit client and is the significance of the self-review threat taken into account?
- Is the auditor aware of the advocacy threat that exists whenever a statutory auditor acts for the audit client in the resolution of a dispute or litigation?

- Is the auditor involved in the recruitment of senior or key staff for the audit client and is he aware of the threats to independence and the self-interest threat that may arise?

### 7.3.2 *Safeguards*

When considering safeguards to reduce or eliminate the threats, the auditor will find it helpful to ask the following questions:

- Is the overall safeguarding system of the statutory auditor implemented? Does it ensure that a remaining independence risk can be reduced to an acceptable level?
- Are arrangements to reduce the risk of self-review by compartmentalising responsibilities and knowledge in specific non-audit engagements adopted by the auditor?
- Are secondary reviews of the statutory audit by an audit partner who is not involved in the provision of any services to the audit client or external reviews by another statutory auditor taken into account?
- Does the auditor undertake routine notifications of any audit and non-audit engagement to those in the audit firm who are responsible for safeguarding independence?
- Are policies and procedures implemented to prohibit professional staff from making management decisions on behalf of the assurance client?
- Are independence issues related to the provision of non-audit services discussed with those charged with governance, such as the audit committee?
- Is the audit client's acknowledgement of responsibility for the results of the work performed by the firm obtained by the auditor?
- Do the statutory auditor's safeguards ensure that the accounting entries and any underlying assumptions (e.g. for valuation purposes) are originated by the client, when the auditor is providing bookkeeping-related assistance?
- Are the services that involve the design and implementation of financial information technology systems (FITS) provided by an expert team comprising different personnel and operating on different reporting lines to those of the audit engagement team?
- Does the audit client acknowledge its responsibilities for establishing, maintaining and monitoring the system of internal controls?
- Is it possible to avoid the audit engagement team being involved in the litigation process by setting up different engagement teams with different reporting lines for the statutory audit and the legal services related to the litigation?
- Are appropriate safeguards put in place to ensure that the auditor does not make management decisions and that the decision as to whom to hire is left to the client?

## CHAPTER 8 – AUDIT AND NON-AUDIT FEES

### 8.1 Introduction

An auditor's objectivity and independence may be threatened or appear to be threatened as a consequence of contingent fees, financial dependency, overdue fees and inadequate pricing.

The EC Recommendation regarding audit and non-audit fees provides that:

- Audit engagements should never be accepted on a contingent fee basis;
- Arrangements for non-audit services should never be concluded without first assessing the independence risk it might create and ensuring that appropriate safeguards are available to reduce the risk to an acceptable level;
- The provision of any (audit and non-audit) services should not be allowed to create a financial dependency;
- Action should be taken in order to avoid a self-interest threat as a consequence of unpaid fees which in turn has the appearance of a loan that gives rise to a mutual financial interest with the client;
- It should be demonstrated that the fee charged for an audit engagement is reasonable.

The above provisions apply to the statutory auditor, the audit firm and the network<sup>11</sup> for services provided to an audit client and its affiliates.

The auditor will need to implement appropriate safeguards to eliminate any threats to independence or to reduce the independence risk to an acceptable level.

### 8.2 Comparison

The IFAC Code of Ethics applies to all assurance engagements whereas the EC Recommendation addresses only the statutory audit. The scope, therefore, of the respective codes is different. Accordingly, this chapter considers only the differences as they apply to the statutory audit.

A summary comparison is set out below.

#### 8.2.1 Threats

##### 8.2.1.1 Contingent Fees

The IFAC Code of Ethics defines contingent fees as being fees calculated on a pre-determined basis relating to the outcome or result of a transaction or the result of the work performed. It expressly provides that fees are not regarded as being contingent if a court or other public authority has established them. The EC Recommendation similarly states that audit fees that are fixed by any court or governmental body do not constitute contingent fees.

Furthermore, the EC Recommendation clarifies the terms “dependency on a contingent event” by giving the following example: the fee depends in some way on the progress or outcome of the project or the attainment of a particular performance figure by the audit client (or its affiliate).

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<sup>11</sup> See Footnote 19 on page 73.

Both the IFAC Code of Ethics and the EC Recommendation list a number of factors to help assess the extent to which other types of contingent fees are a threat to independence.

#### *8.2.1.2 Fees - Relative Size*

The IFAC Code of Ethics and the EC Recommendation both consider financial dependency as posing a threat to independence.

Financial dependency arises, according to the provisions of the IFAC Code of Ethics, when the total fees generated by an assurance client represent a large proportion of an audit firm's total fees, without defining the terms for calculating the proportion.

The EC Recommendation states that financial dependency is considered to exist when the total (audit and non-audit) fees that an audit firm or a network receives or will receive from one audit client and its affiliates make up an unduly high percentage of the total revenues in each year over a five-year period.

No specific percentages are indicated in either the EC Recommendation or in the IFAC Code of Ethics.

Both the IFAC Code of Ethics and the EC Recommendation also consider that a self-interest threat may arise when the fees generated by a client represents a large proportion of the revenue of an individual partner.

Both the EC Recommendation and the IFAC Code of Ethics indicate that in order to assess the threat of financial dependency, factors such as the structure of the firm need to be taken into consideration. The EC Recommendation requires the statutory auditor, the audit firm or the network, in every circumstance, to demonstrate that no financial dependency exists in relation to a particular audit client or its affiliates.

#### *8.2.1.3 Overdue Fees*

The IFAC Code of Ethics and the EC Recommendation indicate that overdue fees might be regarded as a loan.

The EC Recommendation states that a self-interest threat is considered to be so significant that a statutory auditor should not accept re-appointment or, where appropriate and practicable, should resign from the current audit engagement, where fees for audit or other work become significantly overdue and the sum outstanding, or that sum together with fees for current assignments, could be regarded as a loan.

The IFAC Code of Ethics specifies the length of the period based on which fees are supposed to be considered as overdue. Indeed, it states that a self-interest threat may arise if fees due from a client for professional services remain unpaid for a long time, especially if a significant part is not paid before the issuance of the audit report for the following year.

#### 8.2.1.4 Pricing

Both the EC Recommendation and the IFAC Code of Ethics provide that when fees for audit engagements are lower than those charged by a predecessor firm or quoted by other firms, the audit firm should be able to demonstrate that the fees are reasonable, taken into consideration the resources allocated, such as appropriate time and qualified staff assigned to the task and the compliance with standards, guidelines and quality control procedures.

The EC Recommendation also provides that the statutory auditor must be able to demonstrate that a quoted audit fee is not dependent on the expected provision of non-audit services. In addition, it states that where statutory audits of public interest entities are concerned, the statutory auditor should discuss the basis for calculating the audit fee with the governance body of the entity.

### 8.2.2 Safeguards

#### 8.2.2.1 Contingent Fees

The EC Recommendation requires the statutory auditor's safeguarding system to ensure that a contingent fee arrangement for non-audit services is never concluded without assessing the independence risk it might create, and ensuring that appropriate safeguards are available to reduce the risk to an acceptable level.

In addition, the IFAC Code of Ethics prohibits fees in respect of a non-assurance engagement provided to an assurance client and which is contingent on the result of the assurance engagement.

The IFAC Code of Ethics provides examples of safeguards, such as:

- Quality and control policies and procedures;
- Review or determination of the final fee by an unrelated third party;
- Disclosing to the audit committee or others charged with governance the extent and nature of fees charged. This option is also included in the EC Recommendation, which states that a statutory auditor should disclose contingent fee arrangements to the governance body.

#### 8.2.2.2 Fees – Relative Size

In the event that financial dependency arises, the IFAC Code of Ethics suggests safeguards which should be considered and applied as necessary to mitigate the threat. Such safeguards include external quality control reviews and consulting a third party.

The EC Recommendation suggests that an audit partner who is not involved in any of the audit and non-audit engagements should carry out a review of the work done for the client and advise as necessary.

#### 8.2.2.3 Overdue Fees

The IFAC Code of Ethics and the EC Recommendation both suggest as a safeguard review of the work performed by an independent professional accountant or partner not involved in the provision of services to the client.

In addition, the IFAC Code of Ethics suggests as a safeguard discussing the level of outstanding fees with the audit committee or others charged with governance. In the case of a sole practitioner, or a small partnership where all audit partners have been involved with the audit client, the EC recommends that the statutory auditor seeks advice from his professional regulatory body or asks for a review by another statutory auditor.

#### *8.2.2.4 Pricing*

Reference is made in the IFAC Code of Ethics to the need for the firm to be able to demonstrate that appropriate time and qualified staff are assigned to the task and that all applicable assurance standards, guidelines and quality control procedures are being complied with.

### ***8.3 Matters for Consideration by the Auditor***

#### ***8.3.1 Threats***

Contingent fees, financial dependency, overdue fees and inadequate pricing may give rise to “self-interest” or “advocacy” threats.

##### *8.3.1.1 Contingent Fees*

Contingent fees may give rise to self-interest and advocacy threats to independence. When assessing the threats caused by contingent fees, the auditor may find it helpful to ask the following questions:

###### *8.3.1.1.1 Audit Fee Arrangements*

- Has the basis for the calculation of audit fees been agreed in advance?
- Has the scope for variation been included so as to take account of unexpected factors in the work?

###### *8.3.1.1.2 Non-audit Fee Arrangements*

- Has the independence risk been assessed prior to the conclusion of the arrangement and are appropriate safeguards available to reduce the risk to an acceptable level?
- Are fees with respect to a non-assurance engagement provided to an audit client contingent on the result of the audit engagement?
- Are the following factors taken into consideration when assessing the extent to which contingent fee arrangements may give rise to a threat to independence: the relationship between the activity for which the contingent fee is to be paid and the conduct of any current or future audit; the range of possible fee amounts; and the basis on which the fee is to be calculated?
- Is the amount of the contingent fee directly determined by reference to an asset or transaction value or a financial condition the measurement of which will be subsequently exposed to an audit examination and does this increase the self-interest threat to unacceptable levels?

### 8.3.1.2 Fees – Relative Size

The auditor should not provide any (audit and non-audit) services if it creates a financial dependency either in fact or in appearance. When assessing the self-interest threat caused by financial dependency, the auditor may find it helpful to ask the following questions:

- Do the total (audit and non-audit) fees represent an unduly high percentage of the total revenues in each year over a five-year period?
- Are the following factors taken into consideration in order to assess the unduly high percentage of the total income: the size of the firm, whether it is well established or newly created, where it operates, and the general business situation in markets in which it operates?
- Is it possible to demonstrate that no financial dependency exists in relation to the client?
- Are there any fee relationships which may give rise to a financial dependency in respect of a person who is in a position to influence the outcome of the audit?
- Do the fees generated from the client represent a large proportion of the revenue of an individual partner?

### 8.3.1.3 Overdue Fees

A self-interest threat may arise if fees due from an audit client for professional services remain unpaid for a long time, especially if a significant part is not paid before the issuance of the audit report for the following year. Generally the payment of such fees should be required before the report is issued.

When assessing a self-interest threat caused by overdue fees, the auditor will find it helpful to ask the following questions:

- Have fees become significantly overdue? Has a significant part of fees not been paid before the issuance of the audit report for the following year?
- Could fees be regarded as a significant loan?

### 8.3.1.4 Pricing

When a firm obtains an audit engagement with a fee at a significantly lower level than that charged by a predecessor firm or quoted by other firms, a self-interest threat is created. When assessing such a threat, the auditor may find it helpful to ask the following questions:

- Is the auditor able to demonstrate that the fee for an audit engagement is adequate to cover the assignment of appropriate time and qualified staff to the task and to cover compliance with all auditing standards, guidelines and quality control procedures?
- Are the resources allocated at least those which would be allocated to other work of a similar nature?
- Is the agreed audit fee dependent on the expected provision of non-audit services?
- Has the client been misled as to the basis on which future audit and non-audit fees would be charged when negotiating the current audit fees?

## 8.3.2 *Safeguards*

### 8.3.2.1 *Contingent Fees*

Both the EC Recommendation and the IFAC Code of Ethics prohibit contingent fees for audit and assurance engagements.

The EC Recommendation requires the statutory auditor's safeguarding system to ensure that a contingent fee arrangement for non-audit services is never concluded without assessing the independence risk it might create, and ensuring that appropriate safeguards are available to reduce the risk to an acceptable level.

In addition, the IFAC Code of Ethics prohibits fees in respect of a non-assurance engagement provided to an assurance client and which is contingent on the result of the assurance engagement.

For other types of contingent fee arrangements, safeguards should be considered and applied as necessary to reduce the threats to an acceptable level.

Safeguards might include:

- Disclosing to the audit committee, or others charged with governance, the extent of nature and extent of fees charged;
- Review or determination of the final fee by an unrelated third party;
- Quality and control policies and procedures.

### 8.3.2.2 *Fees – Relative Size*

Both the EC Recommendation and the IFAC Code of Ethics consider financial dependency as giving rise to a threat to independence.

Safeguards might include:

- Discussing the extent and nature of fees charged with the audit committee, or others charged with governance;
- Taking steps to reduce dependency on the client;
- External quality control reviews;
- Consulting a third party, such as a professional regulatory body or another professional accountant;
- Policies and procedures to monitor and implement quality control of audit engagements;
- Involving an audit partner or additional professional accountant who is not involved in any audit and non-audit engagements and who is not a member of the engagement team, to carry out a review of the work done for the client or otherwise advise as necessary.

### 8.3.2.3 *Overdue Fees*

Overdue fees might be regarded as being equivalent to a loan and threaten the independence by creating a mutual financial interest with the client.

If the self-interest threat is considered to be so significant, an auditor should not accept re-appointment or, where appropriate and practicable, should resign from the current audit engagement.

In other circumstances the auditor must assess the significance of the threat and take any action that may be necessary. The following safeguards may be applicable:

- Discussing the level of outstanding fees with the audit committee or others charged with governance;
- Involving another statutory auditor or an additional professional accountant not involved in the provision of any services to the client to provide advice or review the work performed;
- Seeking advice from a professional regulatory body.

### 8.3.2.4 *Pricing*

When audit fees are lower than those charged by a predecessor firm or quoted by other firms, the auditor will need to be able to demonstrate that the fees are reasonable, taking into consideration the resources allocated such as appropriate time, qualified staff assigned to the task, and the compliance with standards, guidelines and quality control procedures.

In addition, the EC Recommendation provides that, where statutory audits of public interest entities are concerned, the statutory auditor should discuss the basis for calculating the audit fees with the governance body of the entity.

## CHAPTER 9 – LITIGATION

### *9.1 Introduction*

An auditor's independence may be threatened where litigation takes place, or appears likely to take place, between the statutory auditor and an audit client.

Both, The EC Recommendation and the IFAC Code of Ethics refer to actual or threatened litigation and address the consequences of litigation for the relationship between the auditor and the client.

### *9.2 Comparison*

The IFAC Code of Ethics applies to all assurance engagements whereas the EC recommendation addresses only the statutory audit. The scope, therefore, of the respective codes is different. Accordingly, this chapter considers only the differences as they apply to the statutory audit.

A summary comparison is set out below:

#### *9.2.1 Threats and Safeguards*

##### *9.2.1.1 General*

The EC Recommendation names as parties to the dispute, the statutory auditor, the audit firm or any other person being in a position to influence the outcome of the statutory audit on the one hand and the audit client or its affiliates on the other hand. The IFAC Code of Ethics addresses the relationship between the firm or a member of the assurance team and the client or client management.

##### *9.2.1.2 Self-interest Threats, Advocacy Threats and Intimidation Threats*

Both documents focus on the fact that a self-interest threat may arise when litigation takes place or appears likely between the auditor and the client. In addition to the self-interest threat the EC Recommendation suggests an advocacy threat may arise whereas the IFAC Code of Ethics concludes that an intimidation threat may be created.

The IFAC Code of Ethics emphasises that due to adversarial positions during litigation, the client's management's willingness to make complete disclosures regarding all aspects of a client's business operations may be affected. Therefore, the nature of the engagement should be determined (IFAC Code of Ethics) and all of the audit and non-audit services provided to the client have to be considered in order to assess the threats (EC Recommendation).

### ***9.3 Matters for Consideration by the Auditor***

The general provisions regarding litigation of the EC Recommendation and the IFAC Code of Ethics are comparable with no significant differences. The EC Recommendation provides criteria to assess the point at which it would become improper to continue as statutory auditor whereas the IFAC Code of Ethics considers a number of safeguards to be applied to reduce threats to an acceptable level.

#### ***9.3.1 Threats***

When litigation takes place “self-interest” threats, “advocacy” threats and/or “intimidation” threats may arise. Both documents provide factors that have an impact on the significance of these threats:

- Serious likelihood of litigation which is material to any of the parties involved;
- Litigation which calls into question a previous statutory audit;
- Relation of the litigation to a prior assurance engagement.

#### ***9.3.2 Other Safeguards***

The following safeguard is recommended by both documents to reduce the threats to an acceptable level:

- Disclosing the extent and nature of the litigation to the audit committee, or others charged with governance, and discussion of the basis of the allegations.

The EC Recommendation emphasises the discussion of all relevant aspects with the audit client’s governance body, or, if necessary, with the professional regulatory body. The statutory auditor should also consider seeking legal advice.

The IFAC Code of Ethics, in contrast, provides additional safeguards, such as:

- Removing a person from the assurance team if the litigation involves that individual;
- Involving an additional professional accountant in the firm to review the work done.

Moreover the EC Recommendation specifies that threatened or actual litigation relating to non-audit services for an amount that is not material, would not compromise the statutory auditor’s independence.

Both the EC Recommendation and the IFAC Code of Ethics require where the safeguards do not reduce the threat to an acceptable level, the only appropriate action is to withdraw from, or refuse to accept, the audit engagement.

## CHAPTER 10 – SENIOR PERSONNEL ACTING FOR A LONG PERIOD OF TIME

### *10.1 Introduction*

In many situations senior personnel of the statutory auditor may have worked regularly and for a long time for the same audit client. This situation may include all senior members of the engagement team, including the key audit partner as well as other partners and other senior team members.

In such cases, there is a perceived threat to the independence of the auditor due to familiarity or trust between the auditor and the client. This is particularly so where it involves public interest entity audit clients.

### *10.2 Comparison*

The IFAC Code of Ethics applies to all assurance engagements whereas the EC recommendation addresses only the statutory audit. The scope, therefore, of the respective codes is different. Accordingly, this chapter considers only the differences as they apply to the statutory audit.

Both the EC Recommendations and the IFAC Code of Ethics address the “familiarity” threat that may arise when senior personnel acts on an audit client for a long period of time.

The EC Recommendation uses the term “public interest entity” while the IFAC Code of Ethics text has the term “listed entities”. The EC Recommendation definition, therefore, includes entities that are not included in the IFAC Code of Ethics.

For public interest entities the EC Recommendation requires rotating “key audit partners” and the IFAC Code of Ethics requires “any audit partner” to be rotated. The requirement for replacement after seven years and the requirement for a two-year cooling-off period before a rotated person is allowed to reassume his responsibility are similar<sup>12</sup>.

The EC Recommendation requires that rotation of key audit partners cannot be replaced by other safeguards for public interest entities. It also requires the statutory auditor to consider the independence risk and adopt appropriate safeguards for other senior members of the engagement team.

The IFAC Code of Ethics discusses the circumstances that require the rotation of the lead audit partner but recognises that rotation is not possible in all cases due to for example the size of the firm and offers some degree of flexibility. It nevertheless requires that in such cases appropriate safeguards are implemented to mitigate the threats to independence.

For non public interest entities, the EC Recommendation requires the auditor to use the same procedures as for public interest companies. However, in such cases, safeguards other than rotation may be applied. The IFAC Code of Ethics suggests rotation as one possible safeguard regarding non-listed entities.

<sup>12</sup> This follows from a revision to the IFAC Code of Ethics related to paragraph 151 in section 8 on audit partner rotation which IFAC issued in June 2004.

### ***10.2.1 Threats and Safeguards***

The EC Recommendation states that “familiarity” threats may arise where certain members of the engagement team work regularly and for a long period of time on an audit client engagement, particularly where public interest entity audit clients are concerned. Also the IFAC Code of Ethics states that using the same senior personnel on an engagement over a long period of time may create a familiarity threat.

As stated in paragraph 6.3.1.2 of Chapter 6 - Familiarity Threats, the nature of a familiarity threat may be perceived as the auditor being too trusting because of familiarity, thus resulting in insufficient professional scepticism or testing of representations made.

## ***10.3 Matters for Consideration by the Auditor***

### ***10.3.1 Threats***

Senior personnel of the statutory auditor acting for a long time may bring in to question the independence of the auditor due to “familiarity” threats.

In evaluating the significance of such threats, several factors should be considered by the statutory auditor.

The IFAC Code of Ethics includes some examples of such factors:

- The length of time that the individual has been a member of the team;
- The role of the individual on the team;
- The structure of the firm;
- The nature of the engagements.

In the IFAC Code of Ethics these factors are related to all assurance engagements but are relevant to the statutory auditor.

The EC Recommendation suggests to consider the following factors related to an Audit Client engagement:

- The period of time on an Audit Client engagement;
- Whether the Audit Client is a Public Interest Entity;
- The seniority of staff engaged on the audit;
- The composition of the Engagement Team itself;
- The size of the Audit Firm.

### ***10.3.2 Other Safeguards***

For public interest entities, the EC Recommendation requires replacing the key audit partners of the engagement team (including the engagement partner) within seven years of appointment to the engagement team. It is not possible to counter the rotation requirement for public interest entities by other safeguards.

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For other team members, the EC Recommendation discusses safeguards other than rotation and other measures under the audit firm's quality assurance scheme.

For non public interest entities, it is possible to apply safeguards other than rotation of key audit partners to reduce the independence risk to an acceptable level. For non public interest entities, the EC Recommendation recognises that rotation may not be possible, for example, due to the size of the firm. The EC Recommendation nevertheless requires that safeguards such as external quality review, or as a minimum seeking the advice of a professional regulatory body, be applied.

The IFAC Code of Ethics suggests the same safeguards. It also suggests using another professional accountant who is not a member of the assurance team to review the work.

**Appendix 1 – Glossary and Definitions**

Glossary of the EC Recommendation	Definitions of the IFAC Code of Ethics
No definition provided	<p><u>Advertising</u></p> <p>The communication to the public of information as to the services or skills provided by professional accountants in public practice with a view to procuring professional business.</p>
<p><u>Affiliate</u></p> <p>(a) Of an Audit Firm<sup>13</sup>: an undertaking within the meaning of Article 41 (1), (2) and (3) of the 7<sup>th</sup> Company Law Directive (38/349/EEC):</p> <p>(b) Of an Audit Client: an undertaking within the meaning of Article 41 (1),(2) and (3) of the 7<sup>th</sup> Company Law Directive (83/349/EEC) that together with the Audit Client is required to be included by the consolidation in consolidated accounts prepared in accordance with the 7<sup>th</sup> Directive, or – in those cases where the 7<sup>th</sup> Company Law Directive does not apply – would be required to be included by consolidation were requirements of that Directive to apply.</p> <p>Without prejudice to (a) and (b) the term ‘Affiliate’ will include any undertaking regardless of its legal form, which is connected to another by means of common ownership, control or management.</p>	No definition provided.
No definition provided	<p><u>Assurance Client</u></p> <p>An entity in respect of which a firm conducts an assurance engagement.</p>

<sup>13</sup> The definition of “Affiliate of an Audit Firm” in the proposed Eighth Company Law Directive is different and is as follows: “Affiliate of an audit firm” means any undertaking, regardless of its legal form, which is connected to the audit firm by means of common ownership, control or management.

**Appendix 1 – Glossary and Definitions**

<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
<p align="center">No definition provided</p>	<p><u>Assurance Engagement</u></p> <p>An engagement conducted to provide:</p> <p>(a) A high level of assurance that the subject matter conforms in all material respects with identified suitable criteria; or</p> <p>(b) A moderate level of assurance that the subject matter is plausible in the circumstances.</p> <p>This would include an engagement in accordance with the International Standard on Assurance Engagements issued by the International Auditing and Assurance Standards Board or in accordance with specific standards for assurance engagements issued by the International Auditing Assurance Standards Board such an audit or review of financial statements in accordance with International Standards on Auditing.</p>
<p><u>Assurance Service</u></p> <p>Engagement of a statutory auditor to evaluate or measure a subject matter that is the responsibility of another party against identified suitable criteria, and to express a conclusion that provides the audit client with a level of assurance about that subject matter.</p>	<p><u>Professional Services</u></p> <p>Any service requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services.</p>
<p><u>Audit Client</u></p> <p>The company or firm whose annual accounts are subject to Statutory Audit, or the parent undertaking in the meaning of Article 1 of the 7<sup>th</sup> Company Law Directive (83/349/EEC) whose consolidated accounts are subject to Statutory Audit.</p>	<p><u>Audit Client</u></p> <p>An entity in respect of which a firm conducts an audit engagement. When the audit client is a listed entity, audit client will always include its related entities.</p>

### Appendix 1 – Glossary and Definitions

Glossary of the EC Recommendation	Definitions of the IFAC Code of Ethics
<p><u>Audit Firm</u><sup>14</sup></p> <p>The organisational – generally legal – entity that performs a Statutory Audit (e.g., a sole practitioner’s practice, a partnership or a company of professional accountants). The Audit Firm and the Statutory Auditor who is appointed for the Statutory Audit might be identical legal persons, but need not be, (e.g., where an individual who is a member of a partnership practice is appointed as the Statutory Auditor, the partnership as such forms the Audit Firm).</p>	<p><u>Firm</u></p> <p>(a) A sole practitioner, partnership or corporation of professional accountants;            (b) An entity that controls such parties; and            (c) An entity controlled by such parties.</p>
<p><u>Audit Partner</u></p> <p>An audit professional within an Audit Firm or Network who himself is an approved person in the meaning of Article 2(1) of the Eighth Company Law Directive (=statutory auditor) and, as an individual, takes on ultimate responsibilities for the audit work performed during a Statutory Audit; he, generally, is authorised to sign audit reports on behalf of the Audit Firm which is the Statutory Auditor. He may also be a shareholder/owner or principal of the Audit Firm.</p>	<p>No definition provided</p>
<p><u>Audit Team</u></p> <p>All audit professionals who, regardless of their legal relationship with the Statutory Auditor or Audit Firm, are assigned to a particular Statutory Audit engagement in order to perform the audit task, such as Audit Partner(s), manager(s) and audit staff.</p>	<p><u>Assurance Team</u></p> <p>(a) All professionals participating in the assurance engagement;            (b) All others within a firm who can directly influence the outcome of the assurance engagement, including:</p> <ul style="list-style-type: none"> <li>▪ Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement</li> </ul>

<sup>14</sup> The definition of “Audit Firm” in the proposed Eighth Company Law Directive is different and is as follows: “Audit Firm” means an entity that is approved in accordance with the provisions of the Eighth Company Law Directive by the competent authorities of a Member State to carry out statutory audits regardless of its legal form.

**Appendix 1 – Glossary and Definitions**

<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
	<p>partner in connection with the performance of the assurance engagement. For the purposes of an audit engagement this includes those at all successively senior levels above the lead engagement partner through the firm’s chief executive;</p> <ul style="list-style-type: none"> <li>▪ Those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and</li> <li>▪ Those who provide quality control for the assurance engagement; and</li> </ul> <p>(c) For the purposes of an audit client, all those within a network firm who can directly influence the outcome of the audit engagement</p>
<p><u>Chain of Command</u></p> <p>Comprises all those persons who have a direct supervisory, management, compensation or other oversight responsibility over either any Audit Partner of the Audit Team or over the conduct of the Statutory Audit at office, country, regional or global levels. This includes all Partners, principals and shareholders who may prepare, review or directly influence the performance appraisal of any Audit Partner of the Audit Team or otherwise determine their compensation as a result of their involvement with the audit engagement.</p>	<p align="center">No definition provided</p>
<p align="center">No definition provided</p>	<p><u>Client Account</u></p> <p>Any bank account which is used solely for the banking of clients’ monies.</p>
<p align="center">No definition provided</p>	<p><u>Clients’ Monies</u></p> <p>Any monies – including documents of title to money e.g., bills of exchange, promissory notes, and documents of title which can be converted into money e.g., bearer bonds – received by a professional accountant in public practice to be held or</p>

**Appendix 1 – Glossary and Definitions**

<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
	paid out on the instruction of the person from whom or on whose behalf they are received.
<p><u>Close Family members as defined in the Annex to Chapter 6 – Familiarity Threats</u></p> <p>The term “close family member” normally refers to parents, siblings, spouses or cohabitants, children and other dependants. Depending on the different cultural and social environments in which the audit takes place the term may extend to other family members who may have less immediate but not necessarily less close relationships with the relevant individual. These could include former spouses or cohabitants and the spouses and children of family members.</p>	<p><u>Close Family</u></p> <p>A parent, non-dependent child or sibling.</p>
<p><u>Financial Interests as defined in the Annex to Chapter 1 - Financial Interests</u></p> <p>The term “financial interest” would usually comprise the whole variety of financial interests that the Statutory Auditor himself, his Audit Firm or any other person within the scope of the section A. Framework 2 Responsibility and Scope<sup>15</sup> may have in an Audit Client or in any Affiliate of the client. The term includes ‘direct’ and ‘indirect’ financial interests such as:</p> <ul style="list-style-type: none"> <li>▪ Director indirect shareholding in the Audit Client or its Affiliates,</li> <li>▪ Holding or dealing in securities of the Audit Client or its Affiliates,</li> <li>▪ Accepting pension rights or other benefits from the Audit Client or its Affiliates.</li> </ul> <p>Commitments to hold financial interests (e.g. contractual agreements to acquire a financial interest) and derivatives which are directly related to financial interests (e.g. stock options, futures, etc.) should be dealt with in the same way as would an already existing financial interest.</p>	<p><u>Direct Financial interest</u></p> <p>A financial interest:</p> <ul style="list-style-type: none"> <li>▪ Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or</li> <li>▪ Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control.</li> </ul>

<sup>15</sup> See Footnote 2 on page 19.

**Appendix 1 – Glossary and Definitions**

<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
<p><u>Direct financial Interest</u></p> <p>When a person who is directly involved in the conduct of the statutory audit (the Statutory Auditor, the Audit Firm, an individual in the Engagement Team or within the Chain of Command) holds a direct financial interest in the Audit Client, such as shares, bonds, notes, options, or other securities, the significance of the self-interest threat is considered to be too high to enable any safeguards to reduce the Statutory Auditor’s independence risk to an acceptable level.</p>	
<p>No definition provided</p>	<p><u>Employed Professional Accountant</u></p> <p>A professional accountant employed in industry, commerce, the public sector or education.</p>
<p><u>Engagement Partner</u></p> <p>The Audit Partner who has ultimate responsibilities for the Statutory Audit of a particular Audit Client, who co-ordinates the work of the Audit Team and that of professional personnel from other disciplines involved, ensures that this work is subject to quality control, and, if applicable, co-ordinates all statutory audit activities of a Network which relate to a Statutory Audit, particularly on consolidated accounts where different Audit Partners have different responsibilities for the audits of the entities to be consolidated.</p>	<p>No definition provided</p>
<p><u>Engagement Team</u></p> <p>All persons who, regardless of their legal relationship with the Statutory Auditor or Audit Firm, are directly involved in the acceptance and performance of a particular</p>	<p>No definition provided</p>

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<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
<p>Statutory Audit. This includes the Audit Team, employed or subcontracted professional personnel from other disciplines involved in the audit engagement (e.g. lawyers, actuaries, taxation specialists, IT specialists, treasury management specialists), and those who provide quality control or direct oversight of the audit engagement.</p>	
<p align="center">No definition provided</p>	<p><u>Existing Accountant</u></p> <p>A professional accountant in public practice currently holding an audit appointment or carrying out accounting, taxation, consulting or similar professional services for a client.</p>
<p><u>Financial Interests as defined in the Annex to Chapter 1 - Financial Interests</u></p> <p>The term “financial interest” would usually comprise the whole variety of financial interests that the Statutory Auditor himself, his Audit Firm or any other person within the scope of the section A. Framework 2 Responsibility and Scope<sup>16</sup> may have in an Audit Client or in any Affiliate of the client. The term includes ‘direct’ and ‘indirect’ financial interests such as:</p> <ul style="list-style-type: none"> <li>▪ Director indirect shareholding in the Audit Client or its Affiliates,</li> <li>▪ Holding or dealing in securities of the Audit Client or its Affiliates,</li> <li>▪ Accepting pension rights or other benefits from the Audit Client or its Affiliates.</li> </ul> <p>Commitments to hold financial interests (e.g. contractual agreements to acquire a financial interest) and derivatives which are directly related to financial interests (e.g. stock options, futures, etc.) should be dealt with in the same way as would an already existing financial interest.</p>	<p><u>Financial Interest</u></p> <p>An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives related to such interest.</p>

<sup>16</sup> See Footnote 2 on page 19.

**Appendix 1 – Glossary and Definitions**

<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
<p><u>Governance Body</u></p> <p>A body or a group of persons which is embedded in the Audit Client’s corporate governance structure to exercise oversight over management as a fiduciary for investors and, if required by national law, for other stakeholders such as employees, and which consists of or, at least, includes individuals other than management, such as a supervisory board, an audit committee, or a group of non-executive directors or external board members.</p>	<p><u>Directors and officers</u></p> <p>Those charged with the governance of an entity, regardless of their title, which may vary from country to country.</p>
<p align="center">No definition provided</p>	<p><u>Immediate Family</u></p> <p>A spouse (or equivalent) or dependent.</p>
<p><u>Independence as defined in the Annex to the Framework of the EC Recommendation</u></p> <p>Independence is:</p> <ul style="list-style-type: none"> <li>• Independence of mind, i.e. the state of mind which has regards to all considerations relevant to the task in hand, but no others; and</li> <li>• Independence in appearance, i.e. the avoidance of facts and circumstances which are so significant that a reasonable and informed third party would question the Statutory Auditor’s ability to act objectively.</li> </ul>	<p><u>Independence</u></p> <p>Independence is:</p> <ul style="list-style-type: none"> <li>(a) Independence of mind – the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional scepticism; and</li> <li>(b) Independence in appearance – the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm’s, or a member of the assurance team’s integrity, objectivity or professional scepticism had been compromised.</li> </ul>

**Appendix 1 – Glossary and Definitions**

<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
<p><u>Financial Interests as defined in the Annex to Chapter 1 - Financial Interests</u></p> <p>The term “financial interest” would usually comprise the whole variety of financial interests that the Statutory Auditor himself, his Audit Firm or any other person within the scope of the section A. Framework 2 Responsibility and Scope<sup>17</sup> may have in an Audit Client or in any Affiliate of the client. The term includes ‘direct’ and ‘indirect’ financial interests such as:</p> <ul style="list-style-type: none"> <li>▪ Director indirect shareholding in the Audit Client or its Affiliates,</li> <li>▪ Holding or dealing in securities of the Audit Client or its Affiliates,</li> <li>▪ Accepting pension rights or other benefits from the Audit Client or its Affiliates.</li> </ul> <p>Commitments to hold financial interests (e.g. contractual agreements to acquire a financial interest) and derivatives which are directly related to financial interests (e.g. stock options, futures, etc.) should be dealt with in the same way as would an already existing financial interest.</p> <p><u>Indirect financial interests</u></p> <p>The term ‘indirect financial interest’ refers to a situation where, for example, a person within the scope of A. Framework 2 Responsibility and Scope<sup>18</sup> has investments in non-client entities that have an investment in the Audit Client, or in companies in which an Audit Client also has invested.</p>	<p><u>Indirect financial Interest</u></p> <p>A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control.</p>

<sup>17</sup> See Footnote 2 on page 19.

<sup>18</sup> See Footnote 2 on page 19.

**Appendix 1 – Glossary and Definitions**

<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
<p><u>Key Audit Partner</u></p> <p>An Audit Partner of the Engagement team (including the Engagement Partner) who is at group level responsible for reporting on significant matters, such as on significant subsidiaries or divisions of the Audit Client, or on significant risk factors that relate to the Statutory Audit of that client.</p>	<p><u>Lead Engagement Partner</u></p> <p>In connection with an audit, the partner responsible for signing the report on the consolidated financial statements of the audit client, and where relevant, the partner responsible for signing the report in respect of any entity whose financial statements form part of the consolidated financial statements and on which a separate stand-alone report is issued. When no consolidated financial statements are prepared, the lead engagement partner would be the partner responsible for signing the report on the financial statements.</p>
<p><u>Key Management Position</u></p> <p>Any position at the Audit Client which involves the responsibility for fundamental management decisions at the Audit Client, e.g. a CEO or CFO. This management responsibility should also provide influence on the accounting policies and the preparation of the financial statements of the Audit Client. A Key Management Position also comprises contractual and factual arrangements which by substance allow an individual to participate in exercising this management function in a different way, e.g. via a consulting contract.</p>	<p align="center">No definition provided</p>
<p><u>Network</u><sup>19</sup></p> <p>Includes the Audit Firm which performs the Statutory Audit, together with its Affiliates and any other entity controlled by the Audit Firm or under common</p>	<p><u>Network Firm</u><sup>20</sup></p> <p>An entity under common control, ownership or management with the firm or any entity that a reasonable and informed third party having knowledge of all relevant</p>

<sup>19</sup> The definition of “Network” in the proposed Eighth Company Law Directive is different and is as follows: “Network” means the larger structure to which a statutory auditor or an audit firm belongs and which makes use of common brand-name or through which professional resources are shared.

<sup>20</sup> The IFAC Code of Ethics stipulates that for audit clients, the members of the assurance team, the firm and network firms are required to be independent of the audit client.

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<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
control, ownership or management or otherwise affiliated or associated with the Audit Firm through the use of a common name or through the sharing of significant common professional resources.	information would reasonably conclude as being part of the firm nationally or internationally.
No definition provided	<p><u>Objectivity</u></p> <p>A combination of impartiality, intellectual honesty and a freedom from conflicts of interest.</p>
<p><u>Office</u></p> <p>The term ‘Office’ means a distinct sub-group of an Audit Firm or Network, whether distinguished along geographical or practice lines, in which a Key Audit Partner primarily practices.</p> <p>A main criterion for identifying this sub-group should be the close working relationship between its members (e.g. working on the same kind of subjects or clients). In particular, it should be taken into account, that such working relationships are more and more evolving by means of a ‘virtual’ office, due to technical developments and the increasing multinational activities of Audit Clients.</p> <p>In the case of smaller partnerships, the ‘Office’ may encompass the whole firm, in which case all of the Partners and employees will be subject to the relevant requirements.</p>	<p><u>Office</u></p> <p>A distinct sub-group, whether organised on geographical or practice lines.</p>
<p><u>Partner</u></p> <p>A professional within an Audit Firm or Network who, as an individual, takes on ultimate responsibilities for the work performed during an (audit or non-audit) engagement; he, generally, is authorised to sign on behalf of the Audit Firm, and may</p>	No definition provided

**Appendix 1 – Glossary and Definitions**

<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
also be a shareholder/owner or principal of the Audit Firm.	
No definition provided	<p><u>Practice</u></p> <p>A sole practitioner, a partnership or a corporation of professional accountants which offers professional services to the public.</p>
No definition provided	<p><u>Professional Accountant</u></p> <p>Those persons, whether they be in public practice, (including a sole practitioner, partnership or corporate body), industry, commerce, the public sector or education, who are members of an IFAC Member Body.</p>
No definition provided	<p><u>Professional Accountant in Public Practice</u></p> <p>Each partner or person occupying a position similar to that of a partner, and each employee in a practice providing professional services to a client irrespective of their functional classification (e.g., audit, tax or consulting) and professional accountants in practice having managerial responsibilities. This term is also used to refer to a firm of professional accountants in public practice.</p>

### Appendix 1 – Glossary and Definitions

Glossary of the EC Recommendation	Definitions of the IFAC Code of Ethics
<p><u>Public Interest Entities</u><sup>21</sup></p> <p>Entities which are of significant public interest because of their business, their size, their number of employees or their corporate status is such that they have a wide range of stakeholders. Examples of such entities might include credit institutions, insurance companies, investment firms, UCTIS<sup>22</sup>, pension firms and limited companies.</p>	<p><u>Listed Entity</u></p> <p>An entity whose shares, stock or debt are quoted or listed on a recognised stock exchange or other equivalent body.</p>
No definition provided	<p><u>Publicity</u></p> <p>The communication to the public of facts about a professional accountant which are not designed for the deliberate promotion of that professional accountant.</p>
No definition provided	<p><u>Receiving Accountant</u></p> <p>A Professional accountant in public practice to whom the existing accountant or client of the existing accountant has referred audit, accounting, taxation, consulting or similar appointments, or who is consulted in order to meet the needs of the client.</p>
No definition provided	<p><u>Related Entity</u></p>

<sup>21</sup> The definition of “Public Interest Entities” in the proposed Eighth Company Law Directive is different and is as follows: “Public Interest Entities” means entities that are of significant relevance because of the nature of their business, their size or their number of employees, in particular companies governed by the law of a Member State whose securities are admitted to trading on a regulated market of any Member State within the meaning of Article 1(13) of Council Directive 93/22/EEC (OJL 141, 11/06/1993, p.27), banks and other financial institutions and insurance undertakings.

<sup>22</sup> Undertakings for Collective Investment in Transferable Securities

**Appendix 1 – Glossary and Definitions**

Glossary of the EC Recommendation	Definitions of the IFAC Code of Ethics
	<p>An entity that has any of the following relationships with the client:</p> <ul style="list-style-type: none"> <li>(a) An entity that has direct or indirect control over the client provided the client is material to such entity;</li> <li>(b) An entity with direct financial interest in the client provided that such entity has significant influence over the client and the interest in the client is material to such entity;</li> <li>(c) An entity over which the client has direct or indirect control;</li> <li>(d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial influence over such entity and the interest is material to the client and its related entity in (c); and</li> <li>(e) An entity which is under common control with the client (hereinafter a “sister entity”) provided the sister entity and the client are both material to the entity that controls both the client and sister entity.</li> </ul>
<p align="center">No definition provided</p>	<p><u>Solicitation</u></p> <p>The approach to a potential client for the purpose of offering professional services.</p>
<p><u>Statutory Audit</u><sup>23</sup></p> <p>The audit service which is provided by an approved person in the meaning of Article 2(1) of the 8<sup>th</sup> Company Law Directive (=statutory auditor) when</p> <ul style="list-style-type: none"> <li>(a) Carrying out an audit of the annual accounts of a company or firm and verifying that the annual report is consistent with those annual accounts in so far as such an audit and such a verification is required by community law; or</li> <li>(b) Carrying out an audit of the consolidated accounts of a body of undertakings and verifying that the consolidated annual report is consistent with those</li> </ul>	<p><u>Audit Engagement</u></p> <p>An assurance engagement to provide a high level of assurance that financial statements are free of material misstatement, such as an engagement in accordance with International Standards on Auditing. This includes a statutory audit which is an audit required by national legislation or other regulation.</p>

<sup>23</sup> The definition of “Statutory Audit” in the proposed Eighth Company Law Directive is different and is as follows: “Statutory Audit” means an audit of annual accounts or consolidated accounts in so far as required by Community law and carried out in accordance with the provisions of the Eighth Company Law Directive.

**Appendix 1 – Glossary and Definitions**

<b>Glossary of the EC Recommendation</b>	<b>Definitions of the IFAC Code of Ethics</b>
<p>consolidated accounts in so far as such an audit and such a verification is required by Community law.</p> <p>For the purpose of this Recommendation, the term ‘statutory audit’ would also include an attest service which, dependent on national law, is provided by a statutory auditor when companies are required to have financial reporting information other than the above (e.g. companies’ interim financial accounts and reports) reviewed by a Statutory Auditor who has to give an opinion on this information.</p>	
<p><u>Statutory Auditor</u><sup>24</sup></p> <p>The approved person in the meaning of Article 2(1) of the 8<sup>th</sup> Company Directive (= statutory auditor) who, either being a natural or legal person, is appointed for a certain Statutory Audit engagement by means of national law and – as a consequence – in whose name the audit report is signed.</p>	<p align="center">No definition provided</p>

<sup>24</sup> The definition of “Statutory Auditor” in the proposed Eighth Company Law Directive is different and is as follows: “Statutory Auditor” means a natural person who is approved in accordance with the provisions of the Eighth Company Law Directive by the competent authorities of a Member State to carry out statutory audits.

**Appendix 1 – Chapter 1: Financial Interests**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>1.1. An actual or impending, direct or indirect financial interest in the Audit Client or its Affiliates, including any derivative directly related thereto, may threaten the Statutory Auditor’s independence, if it is held by the Statutory Auditor or any other person being in a position to influence the outcome of the Statutory Audit (any person within the scope of A. Framework 2 Responsibility and Scope<sup>25</sup>).</p> <p>The Statutory Auditor has to assess the significance of any such threat, identify whether any safeguards would mitigate the independence risk it presents, and take any action necessary. This may include refusal of, or resignation from, the audit engagement or exclusion of the relevant person from the Audit Team. Where applicable, and especially with regard to Public Interest Entity clients, the Statutory Auditor should seek to involve the Governance Body in this process.</p>	<p><b>8.102</b> A financial interest in an assurance client may create a self-interest threat. In evaluating the significance of the threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, it is necessary to examine the nature of the financial interest. This includes an evaluation of the role of the person holding the financial interest, the materiality of the financial interest and the type of financial interest (direct or indirect).</p> <p>When evaluating the type of financial interest, consideration should be given to the fact that financial interests range from those where the individual has no control over the investment vehicle or the financial interest held (e.g. a mutual fund, unit trust or similar intermediary vehicle) to those where the individual has control over the financial interest (e.g. as a trustee) or is able to influence investment decisions. In evaluating the significance of any threat to independence, it is important to consider the degree of control or influence that can be exercised over the intermediary, the financial interest held, or its investment strategy. When control exists, the financial interest should be considered direct. Conversely, when the holder of the financial interest has no ability to exercise such control the financial interest should be considered indirect.</p>
<p>1.2. Financial interest in the Audit Client or its Affiliates will be incompatible with the Statutory Auditor’s independence, if</p>	<p><u>Provisions Applicable to all Assurance Clients</u></p> <p><b>8.103</b> If a member of the assurance team, or their immediate family member, has a direct financial interest, or a material indirect financial interest, in the assurance client, the self-interest threat created would be so significant the only safeguards available to eliminate the threat or reduce it to an acceptable level would be to:</p>

<sup>25</sup> See Footnote 2 on page 19.

**Appendix 1 – Chapter 1: Financial Interests**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>1.2a The Statutory Auditor, the Audit Firm, or any member of the Engagement Team or the Chain of Command, or any Partner of the firm or its Network who is working in an “Office”<sup>26</sup> which participates in a significant proportion of an audit engagement, holds</p> <p>1.2a (i) Any direct financial interest in the Audit Client; or            1.2a (ii) Any indirect financial interest in the Audit Client which is significant to either party; or            1.2a (iii) Any (direct or indirect) financial interest in the client’s Affiliates which is significant to either party;</p> <p>1.2 b Any other person within the scope of A. Framework 2 Responsibility and Scope<sup>27</sup>, holds any (direct or indirect) financial interest in the Audit Client or its Affiliates which is significant to either party.</p> <p>Accordingly, the persons concerned should not hold any such financial interests. Where such an interest is acquired as a result of an external event (e.g. inheritance, gift, merger of firms or companies) it must be disposed of as soon as practicable, but no later than one month after the person has knowledge of, and the right to dispose of, the financial interest. In the meantime, additional safeguards are needed to preserve the Statutory auditor’s independence. These could include a secondary review of the relevant person’s audit work or exclusion of the relevant person from any substantive decision making concerning the Statutory Audit of the client.</p>	<p>(a) Dispose of the direct financial interest prior to the individual becoming a member of the assurance team;</p> <p>(b) Dispose of the indirect financial interest in total or dispose of a sufficient amount of it so that the remaining interest is no longer material prior to the individual becoming a member of the assurance team; or</p> <p>(c) Remove the member of the assurance team from the assurance engagement.</p> <p><b>8.106</b> When a member of the assurance team knows that his or her close family member has a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat may be created. In evaluating the significance of any threat, consideration should be given to the nature of the relationship between the member of the assurance team and the close family member and the materiality of the financial interest. Once the significance of the threat has been evaluated, safeguards should be considered and applied as necessary. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• The close family member disposing of all or a sufficient portion of the financial interest at the earliest practical date;</li> <li>• Discussing the matter with those charged with governance, such as the audit committee;</li> </ul>

<sup>26</sup> Defined in the Glossary and Definitions in Appendix 1.

<sup>27</sup> See Footnote 2 on page 19.

**Appendix 1 – Chapter 1: Financial Interests**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>1.3 The Statutory Auditor’s independence may also be threatened by an apparently insignificant financial interest in an Audit Client or its Affiliates. The level of threat will be higher, and likely to be unacceptable, if the interest is neither acquired or held on standard commercial terms nor negotiated on an arm’s length basis. It is the responsibility of the Statutory Auditor to assess the level of risk that such an interest presents and to ensure that any necessary mitigating action is taken.</p> <p><b>Annex</b></p> <p><u>Direct Financial Interests</u></p> <p>When a person who is directly involved in the conduct of the statutory audit (the Statutory Auditor, the Audit Firm, an individual of the Engagement Team or within the Chain of Command) holds a direct financial interest in the Audit Client, such as shares, bonds notes, options, or other securities, the significance of the self-interest threat is considered to be too high to enable any safeguards to reduce the Statutory Auditor’s independence risk to an acceptable level.</p> <p>In such a case the Statutory Auditor either has to withdraw from the engagement or, if an individual of the Audit Firm holds the direct financial interest, has to exclude this individual from the engagement.</p> <p>Where a direct financial interest in the Audit Client is held by a Partner of the Audit Firm or its Network who works in an “Office” the perception of self-interest is considered as being too high to allow this situation to be maintained.</p>	<ul style="list-style-type: none"> <li>• Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team with the close family relationship or otherwise advise as necessary; or</li> <li>• Removing the individual from the assurance engagement.</li> </ul> <p><b>8.107</b> When a firm or a member of the assurance team holds a direct financial interest or a material indirect financial interest in the assurance client as a trustee, a self-interest threat may be created by the possible influence of the trust over the assurance client. Accordingly, such an interest should only be held when:</p> <ul style="list-style-type: none"> <li>(a) The member of the assurance team, an immediate family member of the member of the assurance team, and the firm are not beneficiaries of the trust;</li> <li>(b) The interest held by the trust in the assurance client is not material to the trust;</li> <li>(c) The trust is not able to exercise significant influence over the assurance client; and</li> <li>(d) The member of the assurance team or the firm does not have significant influence over any investment decision involving a financial interest in the assurance client.</li> </ul> <p><b>8.108</b> Consideration should be given to whether a self-interest threat may be created by the financial interests of individuals outside of the assurance team and their immediate and close family members. Such individuals would include:</p> <ul style="list-style-type: none"> <li>• Partners, and their immediate family members, who are not members of the assurance team;</li> </ul>

**Appendix 1 – Chapter 1: Financial Interests**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p><u>Indirect Financial Interests</u></p> <p>A person within the scope of A. Framework 2. Responsibility and Scope<sup>28</sup> should not hold such an indirect financial interest where the self-interest threat resulting from this financial involvement is significant. This is particularly the case when an indirect shareholding in the Audit Client allows or appears to allow that person to influence management decisions of the Audit Client (e.g., by significant indirect voting rights), or when the direct shareholder due to any circumstance could or appears to be able to influence the outcome of the Statutory Audit. In addition, an unacceptable level of independence risk can also arise in situations where the Statutory Auditor or any other person within the scope of A. Framework 2. Responsibility and scope<sup>29</sup> serves as a voting trustee of a trust or executor of an estate containing securities of an Audit Client. However, this will only be the case when there are no appropriate safeguards to mitigate this risk such as supervision and control by beneficiaries, governmental authorities or courts.</p> <p>On the other hand, the potential self-interest threat to the Statutory auditor’s independence may be regarded as insignificant to the independence risk if, for example, when holding indirect financial interests in the Audit Client</p> <ul style="list-style-type: none"> <li>• The financial interest is directly held by an investment fund, pension fund, UCITS or an equivalent investment vehicle, and</li> <li>• The person holding the indirect interest is not directly involved in the audit of the fund manager, nor able to influence the individual investment decisions of the fund manager.</li> </ul>	<ul style="list-style-type: none"> <li>• Partners and managerial employees who provide non-assurance services to the assurance client; and</li> <li>• Individuals who have a close personal relationship with a member of the assurance team.</li> </ul> <p>Whether the interests held by such individuals may create a self-interest threat will depend upon factors such as:</p> <ul style="list-style-type: none"> <li>• The firm’s organizational, operating and reporting structure; and</li> <li>• The nature of the relationship between the individual and the member of the assurance team.</li> </ul> <p>The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Where appropriate, policies to restrict people from holding such interests;</li> <li>• Discussing the matter with those charged with governance, such as the audit committee; or</li> <li>• Involving an additional professional accountant who did not take part in the assurance engagement to review the work done or otherwise advise as necessary.</li> </ul>

<sup>28</sup> See Footnote 2 on page 19.

<sup>29</sup> See Footnote 2 on page 19.

**Appendix 1 – Chapter 1: Financial Interests**

Text of EC Recommendation	Text of IFAC Code of Ethics
	<p align="center"><u>Provisions Applicable to Audit Clients</u></p> <p><b>8.111</b> If a firm, or a network firm, has a direct financial interest in an audit client of the firm the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.</p> <p><b>8.112</b> If a firm, or a network firm, has a material indirect financial interest in an audit client of the firm a self-interest threat is also created. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.</p> <p><b>8.113</b> If a firm, or a network firm, has a material financial interest in an entity that has a controlling interest in an audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. The only actions appropriate to permit the firm, to perform the engagement would be for the firm, or the network firm, either to dispose of the financial interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.</p> <p><b>8.114</b> If the retirement benefit plan of a firm, or network firm, has a financial interest in an audit client a self-interest threat may be created. Accordingly, the significance of any such threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.</p>

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<b>Text of EC Recommendation</b>	<b>Text of IFAC Code of Ethics</b>
	<p><b>8.115</b> If other partners, including partners who do not perform assurance engagements, or their immediate family, in the office in which the lead engagement partner practices in connection with the audit hold a direct financial interest or a material indirect financial interest in that audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such partners or their immediate family should not hold any such financial interests in such an audit client.</p> <p><b>8.116</b> The office in which the lead engagement partner practices in connection with the audit is not necessarily the office to which that partner is assigned. Accordingly, when the lead engagement partner is located in a different office from that of the other members of the assurance team, judgment should be used to determine in which office the partner practices in connection with that audit.</p> <p><b>8.117</b> If other partners and managerial employees who provide non-assurance services to the audit client, except those whose involvement is clearly insignificant, or their immediate family, hold a direct financial interest or a material indirect financial interest in the audit client the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such personnel or their immediate family should not hold any such financial interests in such an audit client.</p> <p><b>8.118</b> A financial interest in an audit client that is held by an immediate family member of (a) a partner located in the office in which the lead engagement partner practices in connection with the audit, or (b) a partner or managerial employee who provides non-assurance services to the audit client is not considered to create an unacceptable threat provided it is received as a result of their employment rights (e.g. pension rights or share options) and, where necessary, appropriate safeguards are applied to reduce any threat to independence to an acceptable level.</p>

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Text of EC Recommendation	Text of IFAC Code of Ethics
<p><u>Financial interest</u></p> <p><b>Annex</b></p> <p>The term “financial interest” would usually comprise the whole variety of financial interests that the Statutory Auditor himself, his Audit Firm or any other person within the scope of section A. Framework 2 Responsibility and Scope<sup>30</sup> may have in an Audit Client or in any Affiliate of the client. The term includes “direct” and “indirect” financial interests such as:</p>	<p><b>8.119</b> A self-interest threat may be created if the firm, or the network firm, or a member of the assurance team has an interest in an entity and an audit client, or a director, officer or controlling owner thereof also has an investment in that entity. Independence is not compromised with respect to the audit client if the respective interests of the firm, the network firm, or member of the assurance team, and the audit client, or director, officer or controlling owner thereof are both immaterial and the audit client cannot exercise significant influence over the entity. If an interest is material, to either the firm, the network firm or the audit client, and the audit client can exercise significant influence over the entity, no safeguards are available to reduce the threat to an acceptable level and the firm, the network firm, should either dispose of the interest or decline the audit engagement. Any member of the assurance team with such a material interest should either:</p> <ul style="list-style-type: none"> <li>(a) Dispose of the interest;</li> <li>(b) Dispose of a sufficient amount of the interest so that the remaining interest is no longer material; or</li> <li>(c) Withdraw from the audit.</li> </ul> <p><u>Definitions</u></p> <p><u>Financial interest:</u></p> <p>An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.</p>

<sup>30</sup> See Footnote 2 on page 19.

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Text of EC Recommendation	Text of IFAC Code of Ethics
<ul style="list-style-type: none"> <li>• Direct or indirect shareholding in the Audit Client or its Affiliates,</li> <li>• Holding or dealing in securities of the Audit Client or its Affiliates,</li> <li>• Accepting pension rights or other benefits from the Audit Client or its Affiliates.</li> </ul> <p>Commitments to hold financial interests (e.g. contractual agreements to acquire a financial interest) and derivatives which are directly related to financial interests (e.g., stock options, futures, etc.) should be dealt with in the same way as would an already existing financial interest.</p> <p>The term “indirect financial interest” refers to situations where, for example, a person within the scope of A. Framework 2 Responsibility and Scope<sup>31</sup> has investments in non-client entities that have an investment in the Audit Client, or in companies in which an Audit Client also has invested.</p> <p>Accordingly, the persons concerned should not hold any such financial interests. Where such an interest is acquired as a result of an external event (e.g. inheritance, gift, merger of firms or companies) it must be disposed of as soon as practicable, but no later than one month after the person has knowledge of, and the right to dispose of, the financial interest. In the meantime, additional safeguards are needed to preserve the Statutory auditor’s independence. These could include a secondary review of the relevant person’s audit work or exclusion of the relevant person from any substantive decision making concerning the Statutory Audit of the client.</p>	<p><u>Direct financial interest:</u></p> <p>A financial interest:</p> <ul style="list-style-type: none"> <li>• Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or</li> <li>• Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control.</li> </ul> <p><u>Indirect financial interest:</u></p> <p>A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control.</p> <p><b>8.105</b> If a member of the assurance team, or their immediate family member receives, by way of, for example, an inheritance, gift or as a result of a merger, a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat would be created. The following safeguards should be applied to eliminate the threat or reduce it to an acceptable level:</p> <ul style="list-style-type: none"> <li>(a) Disposing of the financial interest at the earliest practical date; or</li> <li>(b) Removing the member of the assurance team from the assurance engagement.</li> </ul>

<sup>31</sup> See Footnote 2 on page 19.

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Text of EC Recommendation	Text of IFAC Code of Ethics
<p><b>Annex</b></p> <p><u>External Events</u></p> <p>If a financial interest is acquired as a result of an external event (e.g. inheritance, gift, merger of firms or companies) and a further holding of that interest would create a significant threat to the Statutory Auditor’s independence, it must be disposed of as soon as practicable, but no later than one month after the person has knowledge of and the right to dispose of the financial interest. Where the interest is in a listed company and has been acquired by way of inheritance, for example, the shares should be sold within a month after having both the knowledge of the inheritance and the right to sell the shares in accordance with applicable stock exchange regulations that govern the disposal or sale of shares by those with insider knowledge.</p> <p>Until the financial interest is disposed of, additional safeguards are needed to preserve the Statutory auditor’s independence. For example, where a Statutory Auditor becomes aware that a member of the Engagement Team has acquired shares in a client as the result of inheritance, that individual should not continue to be a member of the Engagement Team until the shares have been sold. He should also be excluded from any substantive decision making concerning the Statutory Audit of the client until the shares have been sold.</p> <p><u>Inadvertent Violations</u></p> <p>There will be occasions where the Statutory Auditor becomes aware that an individual in his Audit Firm inadvertently holds a financial interest in an Audit Client or in one of its Affiliates which, in general, would be regarded as a violation of independence requirements. Such inadvertent violations will not compromise the Statutory Auditor’s independence with respect to an Audit Client, provided that the Statutory Auditor:</p>	<p>During the period prior to disposal of the financial interest or the removal of the individual from the assurance team, consideration should be given to whether additional safeguards are necessary to reduce the threat to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Discussing the matter with those charged with governance, such as the audit committee; or</li> <li>• Involving an additional professional accountant to review the work done, or otherwise advise as necessary.</li> </ul> <p><b>8.109</b> An inadvertent violation of this section as it relates to a financial interest in an assurance client would not impair the independence of the firm, the network firm or a member of the assurance team when:</p> <ol style="list-style-type: none"> <li>(a) The firm, and the network firm, has established policies and procedures that require all professionals to report promptly to the firm any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;</li> <li>(b) The firm, and the network firm, promptly notifies the professional that the financial interest should be disposed of; and</li> <li>(c) The disposal occurs at the earliest practical date after identification of the issue, or the professional is removed from the assurance team.</li> </ol> <p><b>8.110</b> When an inadvertent violation of this section relating to a financial interest in an assurance client has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or</li> <li>▪ Excluding the individual from any substantive decision-making concerning the assurance engagement.</li> </ul>

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Text of EC Recommendation	Text of IFAC Code of Ethics
<ul style="list-style-type: none"> <li>• Has established procedures that require all professional personnel to report promptly any breaches of the independence rules resulting from the purchase, inheritance or other acquisition of a financial interest in an Audit Client by such individuals (see also A. Framework 4.3.2 The Audit Firm’s internal safeguarding system<sup>32</sup>);</li> <li>• Promptly notifies the individual to dispose of the financial interest at the earliest opportunity after the inadvertent violation is identified; and</li> <li>• Takes particular care when reviewing the relevant audit work of this individual.</li> </ul> <p>Where it proves impossible to compel the individual to dispose of the financial interest, the individual should be removed from the Engagement Team. Where an individual other than a member of the Engagement Team inadvertently holds a financial interest that may compromise the Statutory Auditor’s independence, this individual should be excluded from any substantive decision making concerning the Statutory Audit of the client.</p>	

<sup>32</sup> The Audit Firm’s internal safeguarding system

1. A statutory Auditor should set up and maintain a safeguarding system that is an integral part of his firm-wide management and internal control structure.
2. The functioning of such a system should be documented so that it can be subject to quality assurance systems (see A. Framework 4.2. Quality Assurance (Quality assurance systems which meet the minimum requirements of the Commission Recommendation on “Quality Assurance for the Statutory Audit in the EU (C (2000) 3304, 15.11.2000) are required mechanisms contributing to safeguard statutory auditors’ compliance with the independence requirement at a Member State level)).
3. Generally, the safeguarding system of an Audit firm would include:
  - a) Written independence policies which address current independence standards, threats to independence, and the safeguards related thereto;
  - b) Active and timely communication of the policies, and any changes to them, to each Partner, manager and employee, including regular training and education thereon;
  - c) Appropriate procedures to be applied by Partners, managers and employees in order to meet independence standards, both on a regular basis and in response to particular circumstances;
  - d) Designation of top-level audit professionals (Partners) responsible for updating the policies, timely communication of those updates, and overseeing the adequate functioning of the safeguarding system;
  - e) Documentation for each Audit Client that summarises the conclusions that have been drawn from the assessment of threats to the Statutory Auditor’s independence and the related evaluation of the independence risk. This should include the reasoning for these conclusions. If significant threats are noted, the documentation should include a summary of the steps that were, or are to be, taken to avoid or negate the independence risk, or at least reduce it to an appropriate level; and
  - f) Internal monitoring of compliance with safeguarding policies.

<b>Appendix 1 – Chapter 1: Financial Interests</b>	
<b>Text of EC Recommendation</b>	<b>Text of IFAC Code of Ethics</b>
<p>Whatever financial involvement exists, it is primarily the Statutory auditor’s safeguarding system (see A. Framework 4.3 The Statutory Auditor’s overall safeguards<sup>33</sup>) which should provide evidence that the threats to independence have been identified and investigated. Where appropriate, the evidence should also refer to the involvement of the client’s Governance Body in this process. In addition, wherever a decision has been taken about whether or not the threats are significant, the reasons behind that decision should be recorded.</p>	
	<p><i>Note: IFAC deals with loans and guarantees under this financial interests chapter. The EC Recommendation deals with it under the business relationships section. For the purposes of this comparison, the IFAC guidance and analysis thereof have been relocated to the business relationships section in Chapter 2.</i></p>

<sup>33</sup> The Statutory Auditor’s overall safeguards

1. Ownership of and control over Audit Firms

If the Statutory Auditor is an Audit Firm, at least the majority of the firm’s voting rights (50 % plus one vote) must be held by persons who are authorised to perform Statutory Audits within the European Union (statutory auditors: for the purpose of this section in particular, the term “statutory auditors” refers to all natural or legal persons, or other types of company, firm or partnership who, in accordance with the provisions of the 8<sup>th</sup> Company Law Directive (84/253/EEC), are approved by the authorities of the Member States to carry out Statutory Audits.). The Statutory Auditor’s legal statutes should contain provisions to ensure that a non-auditor owner could not gain control the Audit Firm (this paragraph does not apply to an Audit Firm for which the relevant Member State, in accordance with Article 2.1 ii 2<sup>nd</sup> phrase of the 8<sup>th</sup> Directive, does not require a majority of voting rights to be held by statutory auditors, and of which all the shares are registered and can be transferred only with the agreement of the firm and/or with the approval of the national authority competent for the approval of statutory auditors.

2. The Audit Firm’s internal safeguarding system. See Footnote 24 on page 78.

**Appendix 1 – Chapter 2: Business Relationships**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>2.1. Business relationships between the Statutory Auditor, the Audit Firm or any other person being in a position to influence the outcome of the Statutory Audit (any person within the scope of A. Framework 2 Responsibility and Scope<sup>34</sup>) on the one hand, and the Audit Client, its Affiliates, or its management on the other hand, may cause self-interest, advocacy or intimidation threats to the Statutory Auditor’s independence.</p>	<p><i>Note: IFAC deals with loans and guarantees under the financial interests section. The EC Recommendation deals with it under this business relationships section. For the purposes of this comparison, the IFAC guidance and analysis thereof have been relocated to this business relationships chapter.</i></p> <p><u>Close Business Relationship with Assurance Clients</u></p> <p><b>8.130</b> (part) A close business relationship between a firm or a member of the assurance team and the assurance client or its management, or between the firm, a network firm and an audit client, will involve a commercial or common financial interest and may create self-interest and intimidation threats.</p> <p><b>8.130</b> A loan from or a guarantee thereof by, an assurance client that is a bank or a similar institution, to the firm would not create a threat to independence provided the loan is made under normal lending procedures, terms and requirements and the loan is immaterial to both the firm and the assurance client. If the loan is material to the assurance client or the firm it may be possible, through the application of safeguards, to reduce the self-interest threat created to an acceptable level. Such safeguards might include involving an additional professional accountant from outside the firm, or network firm, to review the work performed.</p>

<sup>34</sup> See Footnote 2 on page 19.

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Text of EC Recommendation	Text of IFAC Code of Ethics
<p>2.2. Business relationships, or commitments to establish such relationships, should be prohibited unless the relationship is in the normal course of business and insignificant in terms of the threat it poses to the independence of the Statutory Auditor.</p> <p>Where applicable, and especially with regard to Public Interest Entity clients, the Statutory Auditor should seek to discuss with the Governance Body of the Audit Client any cases where doubt arises whether or not a business relationship is in the normal course of business and insignificant in relation to his independence.</p> <p><b>Annex</b></p> <p><u>In the Normal Course of Business</u></p> <p>In the normal course of its business, a Statutory Auditor may not only provide audit or non-audit services to the Audit Client or to its Affiliates, but may also purchase goods or services from these entities. Examples could include insurance and bank services, commercial loan agreements, the purchase of office equipment, EDP software, or company cars. If these transactions are performed at arm’s length (as between third parties), they generally do not threaten the Statutory Auditor’s independence (e.g. purchase of goods which are offered under normal wholesale discount terms, and are available to the whole of the client’s other customers). However, the Statutory Auditor should carefully consider the risk that even an arm’s length transaction could reach a magnitude which threatens his independence by creating financial dependencies, either in fact or at least in appearance.</p>	<p><b>8.130</b> (part) In the case of an audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm, the network firm and the audit client, no safeguards could reduce the threat to an acceptable level. In the case of an assurance client that is not an audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm and the assurance client, no safeguards could reduce the threat to an acceptable level. Consequently, in both these circumstances the only possible courses of action are to:</p> <ul style="list-style-type: none"> <li>(a) Terminate the business relationship,</li> <li>(b) Reduce the magnitude of the relationship so that the financial interest is immaterial and the relationship is clearly insignificant; or</li> <li>(c) Refuse to perform the assurance engagement.</li> </ul> <p>Unless any such financial interest is immaterial and the relationship is clearly insignificant to the member of the assurance team, the only appropriate safeguard would be to remove the individual from the assurance team.</p> <p><b>8.131</b> In the case of an audit client, business relationships involving an interest held by the firm, a network firm or a member of the assurance team or their immediate family in a closely held entity when the audit client or a director or officer of the audit client, or any group thereof, also has an interest in that entity do not create threats to independence provided:</p> <ul style="list-style-type: none"> <li>(a) The relationship is clearly insignificant to the firm, the network firm and the audit client; General requirement General requirement</li> <li>(b) The interest held is immaterial to the investor, or group of investors; and</li> <li>(c) The interest does not give the investor, or group of investors, the ability to control the closely held entity.</li> </ul>

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Text of EC Recommendation	Text of IFAC Code of Ethics
<p>Accepting any goods or services on favourable terms from an Audit Client is not considered to be within the normal course of business, unless the value of any benefit is insignificant.</p> <p><u>Significance of Independence Risk</u></p> <p>Whether a business relationship should be regarded as a significant threat to the Statutory Auditor’s independence depends on whether a reasonable and informed third party would assume that such a relationship could have an influence on the outcome of the Statutory Audit. Objective criteria are therefore needed in order to evaluate the significance of a relationship to the Statutory Auditor, as well as to the Audit Client. With regard to the financial statements and the audit task, the relationship should not result in the Statutory Auditor, the Audit Firm or one of its Network members being able to influence management decisions of the Audit Client. Conversely, the relationship should not enable the Audit Client, or one of its Affiliates to influence the outcome of the Statutory Audit, either in fact or in appearance.</p> <p>Whatever business relationship exists, it is primarily the Statutory auditor’s safeguarding system (see A. Framework 4.3 The Statutory Auditor’s overall safeguards<sup>35</sup>) which should provide evidence that the threats to independence have been identified and investigated. Where appropriate, the evidence should also refer to the involvement of the client’s Governance Body in this process. In addition, wherever a decision has been taken about whether or not the threats are significant, the reasons behind that decision should be recorded.</p>	<p><b>8.132</b> The purchase of goods and services from an assurance client by the firm (or from an audit client by a network firm) or a member of the assurance team would not generally create a threat to independence providing the transaction is in the normal course of business and on an arm’s length basis. However, such transactions may be of a nature or magnitude so as to create a self-interest threat. If the threat created is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Eliminating or reducing the magnitude of the transaction;</li> <li>• Removing the individual from the assurance team; or</li> <li>• Discussing the issue with those charged with governance, such as the audit committee.</li> </ul> <p><b>8.125</b> A loan from or a guarantee thereof by an assurance client, that is a bank or a similar institution, to a member of the assurance team or their immediate family would not create a threat to independence provided the loan is made under normal lending procedures, terms and requirements. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.</p> <p><b>8.126</b> Similarly, deposits made by, or brokerage accounts of, a firm or a member of the assurance team with an assurance client that is a bank, broker or similar institution would not create a threat to independence provided the deposit or account is held under normal commercial terms.</p> <p><b>8.127</b> If the firm, or a member of the assurance team, makes a loan to an assurance client, that is not a bank or similar institution, or guarantees such an assurance client’s borrowing, the self-interest threat created would be so</p>

<sup>35</sup> See Footnote 32 on page 88.

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	<p>significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.</p> <p><b>8.128</b> Similarly, if the firm or a member of the assurance team accepts a loan from, or has borrowing guaranteed by, an assurance client that is not a bank or similar institution, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.</p> <p><b>8.129</b> The examples in paragraphs 8.124 through 8.128 relate to loans and guarantees between the firm and an assurance client. In the case of an audit engagement, the provisions should be applied to the firm, all network firms and the audit client.</p>
<p><u>Provision of audit services</u></p> <p>2.3. Paragraphs 2.1 and 2.2 above do not apply to the provision of statutory audit services. However, neither the Audit Firm nor any of its Network member firms should provide statutory audit services to</p> <p>2.3a Any owner of the Audit Firm; or</p> <p>2.3b An Affiliate of such an owner where the owner may be in a position to influence any decision-making of the Audit Firm which affects its</p>	<p>No direct equivalent.</p>

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<p>statutory audit function; or</p> <p>2.3c An entity where any individual who has a supervisory or managerial role in that entity may be in a position to influence any decision-making of the Audit Firm which affects its statutory audit function.<sup>36</sup></p> <p><b>Annex</b></p> <p><u>Provision of Statutory Audit Services</u></p> <p>The threat to independence is considered too high to permit a Statutory Auditor, an Audit Firm or any member of its Network to provide statutory audit services to an owner of the Audit Firm. The provision of audit services to an Affiliate of such an owner is also considered incompatible with the independence requirement when that owner is, or appears to be, in a position to influence any decision-making of the Audit Firm that impacts on its statutory audit function. Such an influence may arise, for example, due to the percentage of the voting rights that the owner holds in the Audit Firm. It could also arise due to the nature of the position held by the owner or one of the owner’s representatives in the Audit Firm. A position of potential concern might include a director or senior manager of the owner being a member of the Audit Firm’s supervisory board. Furthermore, the Statutory Auditor should also consider whether the provision of audit services to those clients could compromise his independence where the client’s officers, directors or shareholders either hold a significant amount of voting rights of the Audit Firm or, otherwise, are, or appear to be, in a position to influence the firm’s decision-making with regard to its statutory audit function.</p>	

<sup>36</sup> Paragraph (3) lit. (a) and (b) do not apply to an Audit Firm for which the relevant Member State, in accordance with Article 2.1 (ii) 2<sup>nd</sup> phrase of the 8<sup>th</sup> Directive, does not require a majority of voting rights to be held by statutory auditors, and of which all the shares are registered and can be transferred only with the agreement of the firm and/or with the approval of the national authority competent for the approval of statutory auditors; provided that an *Audit Client* of such an *Audit Firm* is not in a position to influence any decision making of the firm which affects its statutory audit function.

**Appendix 1 – Chapter 2: Business Relationships**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p><b>Annex</b></p> <p>Business relationships are relationships that involve a commercial or financial common interest between the Statutory Auditor, the Audit Firm or any other person being in a position to influence the outcome of the Statutory Audit (any person within the scope of A. Framework 2 Responsibility and Scope<sup>37</sup>) on the one hand and the Audit Client, an Affiliate of the client, or the management thereof on the other. The following are examples of such relationships that would, if significant to the auditor or conducted outside the normal course of business, cause a self-interest, advocacy or intimidation threat:</p> <ul style="list-style-type: none"> <li>• Having a financial interest in a joint venture with the Audit Client, or with an owner, managing director or other individual who performs senior management functions of that client;</li> <li>• Having a financial interest in a non-audit client that has an investor or investee relationship with the Audit Client;</li> <li>• Giving a loan to the Audit Client or guarantees for the Audit Client’s risks;</li> <li>• Accepting a loan from an Audit Client or having borrowings guaranteed by the Audit Client;</li> <li>• Providing services to a managing director or another individual performing a senior management function of the Audit Client in respect of the personal interest of such individual;</li> <li>• Receiving services from the Audit Client or its Affiliates which concern underwriting, offering, marketing or selling of securities issued by the audit firm or one of its group member firms.</li> </ul> <p>Commitments to establish such relationships should be dealt with in the same way as an already established relationship.</p>	<p><b>8.130</b> (part) The following are examples of such relationships:</p> <ul style="list-style-type: none"> <li>• Having a material financial interest in a joint venture with the assurance client or a controlling owner, director, officer or other individual who performs senior managerial functions for that client;</li> <li>• Arrangements to combine one or more services or products of the firm with one or more services or products of the assurance client and to market the package with reference to both parties; and</li> <li>• Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the assurance client’s products or services, or the assurance client acts as the distributor or marketer of the products or services of the firm.</li> </ul>

<sup>37</sup> See Footnote 2 on page 19.

**Appendix 1 – Chapter 3: Employment with the Audit Client**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p><u>Employment with the Audit Client</u></p> <p>3.1. Dual employment of any individual who is in a position to influence the outcome of the Statutory Audit both in the Audit Firm (a person within the scope of A. Framework - 2. Responsibility and Scope<sup>38</sup>) and in the Audit Client or its Affiliates should be prohibited. Loan staff assignments<sup>39</sup> to an Audit Client or any of its Affiliates are also regarded as dual employment relationships. Where an Audit Firm’s employee has worked with an Audit Client under a loan staff assignment and is to be assigned to the audit Engagement Team of that client’s Statutory Audit, this individual should not be given audit responsibility for any function or activity that he was required to perform or supervise during the former loan staff assignment (see also Chapter 5 – Establishing Employment with Audit Firm).</p> <p><b>Annex</b></p> <p><u>Dual employment and loan staff agreements</u></p> <p>The risk to the Statutory Auditor’s independence is considered too high to permit a person within the scope of A. Framework - 2. Responsibility and Scope<sup>40</sup> who is employed by the Audit Firm and/or its Network member firm to also be employed by the Audit Client and/or one of its Affiliates. The</p>	<p><u>Employment with Assurance Clients</u></p> <p><b>8.140</b> A firm or a member of the assurance team’s independence may be threatened if a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement has been a member of the assurance team or partner of the firm. Such circumstances may create self-interest, familiarity and intimidation threats particularly when significant connections remain between the individual and his or her former firm. Similarly, a member of the assurance team’s independence may be threatened when an individual participates in the assurance engagement knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future.</p>

<sup>38</sup> See Footnote 2 on page 19.

<sup>39</sup> An individual who is engaged under a loan staff agreement, works under the direct supervision of the client and does not originate any accounting transaction or prepare original data that is not subject and approval by the client.

<sup>40</sup> See Footnote 2 on page 19.

**Appendix 1 – Chapter 3: Employment with the Audit Client**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>Statutory Auditor’s policies and procedures (see A. Framework - 4.3.2 The Audit Firm’s Internal Safeguarding System<sup>41</sup>) should provide for adequate measures to identify any instance of such dual employment.</p> <p>The Statutory Auditor should also carefully consider those situations where an individual employed by the Audit Firm or a Network member firm works under any loan staff agreement with the Audit Client or one of its Affiliates. A loan staff agreement means an engagement where an employee of the Audit Firm or Network works under the direct supervision of the client and does not originate any accounting transaction or prepare original data that is not subject to review and approval by the client. Such an assignment may be acceptable, provided that the individual is to be assigned to the Engagement Team having completed such a loan staff engagement, he should not be given audit responsibility for any function or activity that he was required to perform or supervise during the former loan staff assignment (see also Chapter 5 - Establishing Employment with Audit Firm).</p>	
<p>3.2. Where a member of the Engagement Team is to leave the Audit Firm and join an Audit Client, policies and procedures of the Audit Firm (see A. Framework - 4.3 The Statutory Auditor’s overall Safeguards<sup>42</sup>) should provide:</p> <p>3.2a A requirement that members of any Engagement Team immediately notify the Audit Firm of any situation involving their potential employment with the Audit Client;</p> <p>3.2b The immediate removal of any such Engagement Team member from the audit engagement; and;</p> <p>3.2c An immediate review of the audit work performed by the resigning or former Engagement Team member in the current and/or (where appropriate) the most recent audit. This review should be performed</p>	

<sup>41</sup> See Footnote 32 on page 88.

<sup>42</sup> See Footnote 32 on page 88.

**Appendix 1 – Chapter 3: Employment with the Audit Client**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>by a more senior audit professional. If the individual joining the client is an Audit Partner or the Engagement Partner, the review should be performed by an Audit Partner who was not involved in the audit engagement. (Where, due to its size, the Audit Firm does not have a Partner who was not involved in the audit engagement, it may seek either a review by another statutory auditor or advice from its professional regulatory body.)</p> <p>3.3. Where a former Engagement Team member or an individual within the Chain of Command has joined an Audit Client, policies and procedures of the Audit Firm should ensure that there remain no significant connections between itself and the individual. This includes:</p> <p>3.3a Regardless of whether the individual was previously involved in the audit engagement, that all capital balances and similar financial interests must be fully settled (including retirement benefits) unless these are made in accordance with pre-determined arrangements that cannot be influenced by any remaining connections between the individual and the Audit Firm;</p> <p>3.3b That the individual does not participate or appear to participate further in the Audit Firm’s business or professional activities.</p> <p>3.4. A Key Audit Partner leaving the audit firm to join the audit client for a Key Management Position, would be perceived to cause an unacceptably high level of independence risk. Therefore, a period of at least two years should have elapsed before a Key Audit Partner can take up a Key Management Position.</p>	<p><b>8.141</b> If a member of the assurance team, partner or former partner of the firm has joined the assurance client, the significance of the self-interest, familiarity or intimidation threats created will depend upon the following factors:</p> <p>(a) The position the individual has taken at the assurance client;</p> <p>(b) The amount of any involvement the individual will have with the assurance team;</p> <p>(c) The length of time that has passed since the individual was a member of the assurance team or firm; and</p> <p>(d) The former position of the individual within the assurance team or firm.</p> <p>The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Considering the appropriateness or necessity of modifying the assurance plan for the assurance engagement;</li> <li>• Assigning an assurance team to the subsequent assurance engagement that is of sufficient experience in relation to the individual who has joined the assurance client;</li> <li>• Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary; or</li> </ul>

**Appendix 1 – Chapter 3: Employment with the Audit Client**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p><b>Annex</b></p> <p><u>Engagement team member joining the Audit Client</u></p> <p>The overall safeguarding system of the Audit Firm (see A. Framework - 4.3 The Statutory Auditor’s overall Safeguards<sup>43</sup>) should include policies and procedures that can be adapted to suit the specific circumstances. These will, for example, depend upon a number of factors such as:</p> <ul style="list-style-type: none"> <li>• The position of the departing individual at the Audit Firm (e.g. Partner vs. senior or other professional).</li> <li>• The circumstances which lead to the departure (e.g. retirement, termination, voluntary withdrawal).</li> <li>• The position the departing individual is taking at the client (e.g. managerial position vs. position with insignificant influence on the financial statements).</li> <li>• The length of time that has passed since the individual left the Audit Firm, and</li> <li>• The length of time that has elapsed since the departing individual performed services related to the audit engagement.</li> </ul> <p><u>Second Partner’s review</u></p> <p>In cases, where the individual leaving the Audit Firm was an Engagement or Audit Partner, the required review by another Audit Partner should also consider the risk that the former partner might have been influenced by the client during the previous audit. In addition, the former partner may have established close relationships with other Audit Team members which might threaten the independence of those staying on the Audit Team. Finally, the</p>	<ul style="list-style-type: none"> <li>• Quality control review of the assurance engagement.</li> </ul> <p>In all cases, all of the following safeguards are necessary to reduce the threat to an acceptable level:</p> <ul style="list-style-type: none"> <li>(a) The individual concerned is not entitled to any benefits or payments from the firm unless these are made in accordance with fixed pre-determined arrangements. In addition, any amount owed to the individual should not be of such significance to threaten the firm’s independence; and</li> <li>(b) The individual does not continue to participate or appear to participate in the firm’s business or professional activities.</li> </ul> <p><b>8.142</b> A self-interest threat is created when a member of the assurance team participates in the assurance engagement while knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future. This threat can be reduced to an acceptable level by the application of all of the following safeguards:</p> <ul style="list-style-type: none"> <li>(a) Policies and procedures to require the individual to notify the firm when entering serious employment negotiations with the assurance client; and</li> <li>(b) Removal of the individual from the assurance engagement.</li> </ul> <p>In addition, consideration should be given to performing an independent review of any significant judgments made by that individual while on the engagement.</p>

<sup>43</sup> See Footnote 32 on page 88.

**Appendix 1 – Chapter 3: Employment with the Audit Client**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>former partner could use his knowledge of the current audit approach and testing strategy to circumvent the audit designs.</p> <p>It might be appropriate for a small Audit Firm which is not able to perform a second Partner’s review either to have a similar review performed by another statutory auditor or, at least, to seek advice from its professional regulatory authority.</p>	<p align="center"><u>Temporary Staff Assignments to Audit Clients</u></p> <p><b>8.189</b> The lending of staff by a firm, or network firm, to an audit client may create a self-review threat when the individual is in a position to influence the preparation of a client’s accounts or financial statements. In practice, such assistance may be given (particularly in emergency situations) but only on the understanding that the firm’s or network firm’s personnel will not be involved in:</p> <ul style="list-style-type: none"> <li>(a) Making management decisions;</li> <li>(b) Approving or signing agreements or other similar documents; or</li> <li>(c) Exercising discretionary authority to commit the client.</li> </ul> <p>Each situation should be carefully analyzed to identify whether any threats are created and whether appropriate safeguards should be implemented.</p> <p>Safeguards that should be applied in all circumstances to reduce any threats to an acceptable level include:</p> <ul style="list-style-type: none"> <li>• The staff providing the assistance should not be given audit responsibility for any function or activity that they performed or supervised during their temporary staff assignment; and</li> <li>• The audit client should acknowledge its responsibility for directing and supervising the activities of firm, or network firm, personnel.</li> </ul>

**Appendix 1 – Chapter 4: Managerial or Supervisory Role in Audit Client**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>4.1. An individual who is in a position to influence the outcome of the Statutory Audit (a person within the scope of A. Framework - 2. Responsibility and Scope) should not be a member of any management body (e.g. board of directors) or supervisory body (e.g. audit committee or supervisory board) of an Audit Client. Also, he should not be a member of such a body in an entity which holds directly or indirectly more than 20 % of the voting rights in the client, or in which the client holds directly or indirectly more than 20 % of the voting rights.</p> <p><b>Annex</b></p> <p>The acceptance of a managerial or supervisory role in an Audit Client is not the only potential concern with regard to intimidation and self-review threats. Such threats can also arise when an individual within the scope of (A. Framework - 2. Responsibility and Scope<sup>44</sup>) becomes a member of a managerial or supervisory body of an entity that is not an Audit Client (non-client entity), but is either in a position to influence the Audit Client or to be influenced by the Audit Client. In these cases, the level of independence risk is unacceptably high. The acceptance of such positions should therefore be prohibited.</p>	<p><u>Serving as an Officer or Director on the Board of Assurance Clients</u></p> <p><b>8.146</b> If a partner or employee of the firm serves as an officer or as a director on the board of an assurance client the self-review and self-interest threats created would be so significant no safeguard could reduce the threats to an acceptable level. In the case of an audit engagement, if a partner or employee of a network firm were to serve as an officer or as a director on the board of an audit client the threats created would be so significant no safeguard could reduce the threats to an acceptable level. Consequently, if such an individual were to accept such a position the only course of action is to refuse to perform, or to withdraw from the assurance engagement.</p>

<sup>44</sup> See Footnote 2 on page 19.

**Appendix 1 – Chapter 4: Managerial or Supervisory Role in Audit Client**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p><b>Annex</b></p> <p>Where national law requires members of the audit profession to undertake supervisory roles in certain companies, safeguards must ensure that such professionals do not have any responsibility with regard to the Engagement Team.</p>	
	<p><b>8.147</b> The position of Company Secretary has different implications in different jurisdictions. The duties may range from administrative duties such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally this position is seen to imply a close degree of association with the entity and may create self-review and advocacy threats.</p> <p><b>8.148</b> If a partner or employee of the firm or a network firm serves as Company Secretary for an audit client the self-review and advocacy threats created would generally be so significant, no safeguard could reduce the threat to an acceptable level. When the practice is specifically permitted under local law, professional rules or practice, the duties and functions undertaken should be limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns.</p> <p><b>8.149</b> Routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters is generally not perceived to impair independence, provided client management makes all relevant decisions.</p>

**Appendix 1 – Chapter 4: Managerial or Supervisory Role in Audit Client**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>4.2. When a former member of the Engagement Team takes a managerial or supervisory role in an Audit Client, Chapter 3 - Employment with the Audit Client 3.3 and 3.4 will apply.</p> <p><b>Annex</b></p> <p>4. 2 recognises that a former member of an Engagement Team who leaves the Audit Firm, whether to retire or to take up a post with a non-client entity, might be invited to take a non-executive post on a management or supervisory body of the Audit Client. In such cases, the Audit Firm will need to ensure that the requirements of Chapter 3 - Employment with the Audit Client 3.3. and 3.4. are met.</p>	<p><u>Employment with assurance clients</u></p> <p><b>8.140</b> A firm or a member of the assurance team’s independence may be threatened if a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement has been a member of the assurance team or partner of the firm. Such circumstances may create self-interest, familiarity and intimidation threats particularly when significant connections remain between the individual and his or her former firm. Similarly, a member of the assurance team’s independence may be threatened when an individual participates in the assurance engagement knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future.</p>

**Appendix 1 – Chapter 5: Establishing Employment with Audit Firm**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p><u>A former director or manager of the Audit Client who has joined the Audit Firm – The Engagement Team</u></p> <p>5.1. (part) Where a director or manager of the Audit Client has joined the Audit Firm, this person should not become a member of the Engagement Team at any time in the two-year period after leaving the Audit Client.</p> <p><b>Annex</b></p> <p>When a director or manager of an Audit Client joins the Audit Firm, the self-review threat is considered as too high to be mitigated by any safeguard other than the prohibition of such a person from becoming a member of the Engagement Team or from taking part in any substantive decisions concerning the client’s audit for a two year period.</p>	<p><b>8.143</b> To have a former officer, director or employee of the assurance client serve as a member of the assurance team may create self-interest, self-review and familiarity threats. This would be particularly true when a member of the assurance team has to report on, for example, subject matter he or she had prepared or elements of the financial statements he or she had valued while with the assurance client.</p>
<p>5.1. (part) If the person is a member of the Chain of Command, he should not take part in any substantive decisions concerning an audit engagement with this client or with one of its Affiliates at any time in the two-year period after leaving the Audit Client. This requirement also applies to a former employee of the Audit Client unless the responsibilities he held and the tasks he performed at the Audit Client were insignificant in relation to the statutory audit function.</p> <p><b>Annex</b></p> <p>(part) Where a former employee of the Audit Client joins the Audit Firm, the significance of the self-review threat will relate to the responsibilities and tasks this employee had at the Audit Client and those he is going to take at the Audit Firm. For example, if the former employee prepared accounts or valued</p>	

**Appendix 1 – Chapter 5: Establishing Employment with Audit Firm**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>elements of the financial statements, the same safeguards would apply as for a director or manager; on the other hand, when the former employee held, for example, a non-management position in a branch of the Audit Client, the self review threat may be mitigated if his activities as a member of the Engagement Team do not relate to that branch.</p>	
	<p><b>8.144</b> If, during the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement, the threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, such individuals should not be assigned to the assurance team.</p>
	<p><b>8.145</b> If, prior to the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement, this may create self-interest, self-review and familiarity threats. For example, such threats would be created if a decision made or work performed by the individual in the prior period, while employed by the assurance client, is to be evaluated in the current period as part of the current assurance engagement. The significance of the threats will depend upon factors such as:</p> <ul style="list-style-type: none"> <li>• The position the individual held with the assurance client;</li> <li>• The length of time that has passed since the individual left the assurance client; and</li> <li>• The role the individual plays on the assurance team.</li> </ul> <p>The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as</p>

**Appendix 1 – Chapter 5: Establishing Employment with Audit Firm**

<b>Text of EC Recommendation</b>	<b>Text of IFAC Code of Ethics</b>
	<p>necessary to reduce the threat to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Involving an additional professional accountant to review the work done by the individual as part of the assurance team or otherwise advise as necessary; or</li> <li>• Discussing the issue with those charged with governance, such as the audit committee.</li> </ul>

**Appendix 1 – Chapter 6: Family and other Personal Relationships**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>6.1. An individual who is a Statutory Auditor should not accept an audit engagement if one of his close family members:</p> <p>6.1a Holds a senior management position with the Audit Client;</p> <p>6.1b Is in a position to exert direct influence on the preparation of the Audit Client’s accounting records or financial statements;</p> <p>6.1c Has a financial interest in the Audit Client (see Chapter 1 – Financial Interests) unless it is insignificant; or</p> <p>6.1d Has a business relationship with the Audit Client (see Chapter 2 – Business Relationships) unless it is in the normal course of business and insignificant in terms of the threat it poses to the independence of the Statutory Auditor.</p> <p>6.2. Within an Audit Firm or Network an individual should not be assigned to the Engagement Team if one of his close family members meets any of the criteria under 6.1a to 6.1d above, nor should an Audit Partner who is working in an “Office” where any of the other Partners in it has a close family member who meets these criteria.</p> <p>Appropriate safeguards should ensure that a member of the Chain of</p>	<p><u>Family and Personal Relationships</u></p> <p><b>8.133</b> Family and personal relationships between a member of the assurance team and a director, an officer or certain employees, depending on their role, of the assurance client, may create self-interest, familiarity or intimidation threats. It is impracticable to attempt to describe in detail the significance of the threats that such relationships may create. The significance will depend upon a number of factors including the individual’s responsibilities on the assurance engagement, the closeness of the relationship and the role of the family member or other individual within the assurance client. Consequently, there is a wide spectrum of circumstances that will need to be evaluated and safeguards to be applied to reduce the threat to an acceptable level.</p> <p><b>8.134</b> When an immediate family member of a member of the assurance team is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement, or was in such a position during any period covered by the engagement, the threats to independence can only be reduced to an acceptable level by removing the individual from the assurance team. The closeness of the relationship is such that no other safeguard could reduce the threat to independence to an acceptable level. If application of this safeguard is not used, the only course of action is to withdraw from the assurance engagement. For example, in the case of an audit of financial statements, if the spouse of a member of the assurance team is an employee in a position to exert direct and significant influence on the preparation of the audit client’s accounting records or financial statements, the threat to independence could only be reduced to an acceptable level by removing the individual from the assurance team.</p>

**Appendix 1 – Chapter 6: Family and other Personal Relationships**

<b>Text of EC Recommendation</b>	<b>Text of IFAC Code of Ethics</b>
<p>Command does not participate in any decisions that directly relate to the audit engagement if one of his close family members meets any of the criteria under 6.1a to 6.1d above, or if he is working in an “Office” where any of the Partners in it has a close family member who meets these criteria.</p> <p>6.3. The Statutory Auditor should consider whether he or any other individual in the Engagement Team or Chain of Command, or any person working in an “Office” which includes himself or such an individual, has any other close personal relationships where similar safeguards would be needed.</p> <p>6.4. Assessment of the facts of a relevant individual’s close personal relationship should be based upon the knowledge of the Statutory Auditor and the individual concerned. The individual should be responsible for disclosing to the Statutory Auditor any fact and circumstance which might require safeguards to mitigate an unacceptable level of independence risk.</p> <p><b>Annex</b></p> <p>The Statutory Auditor must be able to assess the risk to his independence when he or any member of the audit Engagement Team or the Chain of Command, or any Partner in an “Office” which includes himself or such an individual, has any close family member or any other close personal relationship with anyone who meets the criteria under 6.1a to 6.1d. His consideration of the facts should be based on his knowledge of the circumstances of all relevant individuals within the Audit Firm or its Network. Policies and procedures should be in place that require such individuals to disclose to the best of their knowledge, on which the Statutory Auditor would then rely, any fact or circumstance which need to be taken into account. The Statutory Auditor should evaluate all such information, determine whether any of the criteria are met and take any necessary mitigating action within a reasonable period of time. This might include refusal of the engagement, or exclusion of an individual from the Engagement Team or the “Office”.</p>	

**Appendix 1 – Chapter 6: Family and other Personal Relationships**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>The Audit Firm’s policies and procedures should make it clear that it is the responsibility of individuals in the Engagement Team or Chain of Command or “Office” to assess to the best of their knowledge who are, or might appear to be, their close family members and close non-family contacts. They should disclose any relevant facts or circumstances in respect of a particular Audit Client to the Audit Partner in charge of the engagement.</p> <p><u>Close family members</u></p> <p>The term “close family member” normally refers to parents, siblings, spouses or cohabitants, children and other dependants. Depending on the different cultural and social environments in which the audit takes place, the term may extend to other family members who may have less immediate but not necessarily less close relationships with the relevant individual. These could include former spouses or cohabitants and the spouses and children of family members.</p> <p><u>Close Non-family Relationships</u></p> <p>Close relationships other than family ones are hard to define, but could include a relationship with any person other than a family member which entails frequent or regular social contact.</p>	<p><b>8.135</b> When a close family member of a member of the assurance team is a director, an officer, or an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement, threats to independence may be created. The significance of the threats will depend on factors such as:</p> <ul style="list-style-type: none"> <li>• The position the close family member holds with the client; and</li> <li>• The role of the professional on the assurance team.</li> </ul> <p>The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Removing the individual from the assurance team;</li> <li>• Where possible, structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the close family member; or</li> <li>• Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.</li> </ul>

**Appendix 1 – Chapter 6: Family and other Personal Relationships**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p><u>Inadvertent Violations</u></p> <p>There will be occasions where the Statutory Auditor becomes aware that an individual in his Audit Firm inadvertently has not reported to the firm a family or other personal relationship with an Audit Client which, in general, would be regarded as a violation of independence requirements. Such inadvertent violations will not compromise the Statutory Auditor’s independence with</p>	<p><b>8.136</b> In addition, self-interest, familiarity or intimidation threats may be created when a person who is other than an immediate or close family member of a member of the assurance team has a close relationship with the member of the assurance team and is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement. Therefore, members of the assurance team are responsible for identifying any such persons and for consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship and the role of the individual within the assurance client.</p> <p><b>8.137</b> Consideration should be given to whether self-interest, familiarity or intimidation threats may be created by a personal or family relationship between a partner or employee of the firm who is not a member of the assurance team and a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement. Therefore partners and employees of the firm are responsible for identifying any such relationships and for consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship, the interaction of the firm professional with the assurance team, the position held within the firm, and the role of the individual within the assurance client.</p> <p><b>8.138</b> An inadvertent violation of this section as it relates to family and personal relationships would not impair the independence of a firm or a member of the assurance team when:</p> <p>(a) The firm has established policies and procedures that require all</p>

**Appendix 1 – Chapter 6: Family and other Personal Relationships**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>respect to an Audit Client, provided that the Statutory Auditor:</p> <ul style="list-style-type: none"> <li>• Has established procedures that require all professional personnel to report promptly any breaches of the independence rules resulting from changes in their family or other personal relationships, the acceptance of an audit sensitive position by their close family members or other close persons (i.e., those falling within the scope of 6.1a and 6.1b above), or the purchase, inheritance or other acquisition of a significant financial interest in an Audit Client by such family members or persons;</li> <li>• Promptly removes the individual from the Engagement Team, or if the individual is not a member of the Engagement Team, excludes him from substantive decisions concerning the Statutory Audit of the relevant client. In the case of a significant financial interest, he should notify the individual to ensure that the financial interest is disposed of at the earliest opportunity after the inadvertent violation is identified; and</li> <li>• Takes particular care when reviewing the relevant audit work of this individual.</li> </ul>	<p>professionals to report promptly to the firm any breaches resulting from changes in the employment status of their immediate or close family members or other personal relationships that create threats to independence;</p> <p>(b) Either, the responsibilities of the assurance team are re-structured so that the professional does not deal with matters that are within the responsibility of the person with whom he or she is related or has a personal relationship, or, if this is not possible, the firm promptly removes the professional from the assurance engagement; and</p> <p>(c) Additional care is given to reviewing the work of the professional.</p> <p><b>8.139</b> When an inadvertent violation of this section relating to family and personal relationships has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or</li> <li>• Excluding the individual from any substantive decision-making concerning the assurance engagement.</li> </ul>

**Appendix 1 – Chapter 7: Non-Audit Services**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>7.1. <u>General</u></p> <p>7.1.1. Where a Statutory Auditor, an Audit Firm or one of its Network member firms provides services other than statutory audit work (non-audit services) to an Audit Client or to one of its Affiliates, the overall safeguarding system (A. Framework 4.3. The Statutory Auditor’s overall safeguards<sup>45</sup>) of the Statutory Auditor has to ensure that:</p> <p>(a) The individuals employed by either the Audit Firm or its Network member firm neither take any decision nor take part in any decision-making on behalf of the Audit Client or one of its Affiliates, or its management while providing a non-audit service; and</p> <p>(b) Where an independence risk remains due to specific threats which may result from the nature of a non-audit service, this risk is reduced to an acceptable level.</p> <p>7.1.2. Even if not involved in the decision-making of the Audit Client or any of its Affiliates, the Statutory Auditor should consider, amongst others, which of the following safeguards in particular may mitigate a remaining independence threat:</p> <p>(a) Arrangements to reduce the risk of self-review by compartmentalising responsibilities and knowledge in specific non-audit engagements;</p> <p>(b) Routine notification of any audit and non-audit engagement to those in the Audit Firm or Network who are responsible for safeguarding independence, including oversight of ongoing activities;</p>	<p><u>Provision of Non-assurance Services to Assurance Clients</u></p> <p><b>8.155</b> Firms have traditionally provided to their assurance clients a range of non-assurance services that are consistent with their skills and expertise. Assurance clients value the benefits that derive from having these firms, who have a good understanding of the business, bring their knowledge and skill to bear in other areas. Furthermore, the provision of such non-assurance services will often result in the assurance team obtaining information regarding the assurance client’s business and operations that is helpful in relation to the assurance engagement. The greater the knowledge of the assurance client’s business, the better the assurance team will understand the assurance client’s procedures and controls, and the business and financial risks that it faces. The provision of non-assurance services may, however, create threats to the independence of the firm, a network firm or the members of the assurance team, particularly with respect to perceived threats to independence. Consequently, it is necessary to evaluate the significance of any threat created by the provision of such services. In some cases it may be possible to eliminate or reduce the threat created by application of safeguards. In other cases no safeguards are available to reduce the threat to an acceptable level.</p> <p><b>8.156</b> The following activities would generally create self-interest or self-review threats that are so significant that only avoidance of the activity or refusal to perform the assurance engagement would reduce the threats to an acceptable level:</p>

<sup>45</sup> See Footnote 32 on page 88.

**Appendix 1 – Chapter 7: Non-Audit Services**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>(c) Secondary reviews of the Statutory Audit by an Audit Partner who is not involved in the provision of any services to the Audit Client or to one of its Affiliates; or</p> <p>(d) External review by another statutory auditor or advice by the professional regulatory body.</p> <p>7.1.3. Where applicable, and especially with regard to Public Interest Entity clients, the Statutory Auditor should seek to discuss the provision of non-audit services to an Audit Client or to one of its Affiliates with the client’s Governance Body (see A. Framework 4.1.2. Involvement of the Governance Body<sup>46 47</sup>).</p>	<ul style="list-style-type: none"> <li>• Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of the assurance client, or having the authority to do so;</li> <li>• Determining which recommendation of the firm should be implemented; and</li> <li>• Reporting, in a management role, to those charged with governance.</li> </ul> <p><b>8.157</b> The examples set out in paragraphs 8.163 through 8.202 are addressed in the context of the provision of non-assurance services to an assurance client. The potential threats to independence will most frequently arise when a non-assurance service is provided to an audit client. The financial statements of an entity provide financial information about a broad range of transactions and events that have affected the entity. The subject matter of other assurance services, however, may be limited in nature. Threats to</p>

<sup>46</sup> Involvement of the Governance Body

1. Where a Public Interest Entity has a Governance Body (see Footnote 47 Governance structure’s impact on independence risk assessment), the Statutory Auditor should at least annually:
  - a. Disclose to the Governance Body, in writing:
    - i. The total amount of fees that he, the Audit Firm and its Network members have charged to the Audit Client and its Affiliates for the provision of services during the reporting period. This total amount should be broken into four broad categories of services: Statutory audit services; further assurance services (Defined in the Glossary and Definitions); tax advisory services; and other non-audit services. The category of other non-audit services should be further broken down into subcategories so far as items in them differ substantially from one another. This break-down into subcategories should at least provide information on fees for the provision of financial information technology, internal audit, valuation, litigation and recruitment services. For each (sub-) category of service, the amounts charged and contracted for, as well as existing proposals or bids for future services contracts should be separately analysed;
    - ii. Details of all relationships between himself, the Audit Firm and its Networks member firms, and the Audit Client and its Affiliates (Defined in the Glossary and Definitions) that he believes may reasonably be thought to bear on his independence and objectivity; and
    - iii. The related safeguards that are in place;
  - b. Confirm in writing that, in his professional judgement, the Statutory Auditor is independent within the meaning of regulatory and professional requirements and the objectivity of the Statutory Auditor is not compromised, or otherwise declare that he has concerns that his independence and objectivity may be compromised; and
  - c. Seek to discuss these matters with the Governance Body of the Audit Client.
2. Where Audit Clients other than Public Interest Entities have a Governance Body, the Statutory Auditor should consider whether similar measures are appropriate.

<sup>47</sup> Governance structure’s impact on independence risk assessment

- The Statutory Auditor should consider whether the governance structure of the audited entity provides safeguards to mitigate threats to his independence and how these safeguards are operated. Such safeguards include:
1. that appointment of the Statutory Auditor by persons other than the audited entity’s management; and
  2. oversight and communications within the audited entity regarding the Statutory Audit and other services provided to it by the Audit Firm or its Network.

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Text of EC Recommendation	Text of IFAC Code of Ethics
<p><b>Annex</b></p> <p><b>7.1 General</b></p> <p><u>Independence from Audit Client’s Decision-Making</u></p> <p>The self-review threat is always considered too high to allow the provision of any services other than statutory audit work that involves the Statutory Auditor in any decision-making of either the Audit Client, any of its Affiliates, or the management of such an entity. Therefore, if the Statutory Auditor or a member within his Network intends to provide non-audit services to an Audit Client or to one of its Affiliates, the Statutory Auditor has to ensure that any individual acting for or on behalf of the Audit Firm or its Network member does not take any decision for, nor take part in any decision-making on behalf of, the Audit Client, any of its Affiliates or the management of such an entity.</p> <p>Any advice or assistance related to any service provided by the Statutory Auditor or the Audit Firm should give the Audit Client, a client’s Affiliate or the management of such an entity the opportunity to decide between reasonable alternatives. This does not prevent the Statutory Auditor, Audit Firm or one of its Network members from making recommendations to the Audit Client. However, such advice should be justified by objective and transparent analyses in the expectation that the Audit Client will review the recommendations before reaching any decision. If the Audit Client is seeking advice where, due to legal or regulatory provisions, only one solution is available, the Statutory Auditor should ensure that his documentation refers to these provisions (e.g. quotes the relevant law, includes advice from external professionals).</p>	<p>independence, however, may also arise when a firm provides a non-assurance service related to the subject matter of a non-audit assurance engagement. In such cases, consideration should be given to the significance of the firm’s involvement with the subject matter of the non-audit assurance engagement, whether any self-review threats are created and whether any threats to independence could be reduced to an acceptable level by application of safeguards, or whether the non-assurance engagement should be declined. When the non-assurance service is not related to the subject matter of the non-audit assurance engagement, the threats to independence will generally be clearly insignificant.</p> <p><b>8.158</b> The following activities may also create self-review or self-interest threats:</p> <ul style="list-style-type: none"> <li>• Having custody of an assurance client’s assets;</li> <li>• Supervising assurance client employees in the performance of their normal recurring activities; and</li> <li>• Preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction (for example, purchase orders, payroll time records, and customer orders).</li> </ul> <p>The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Making arrangements so that personnel providing such services do not participate in the assurance engagement;</li> <li>• Involving an additional professional accountant to advise on the potential impact of the activities on the independence of the firm and the assurance team; or</li> <li>• Other relevant safeguards set out in national regulations.</li> </ul>

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	<p><b>8.159</b> New developments in business, the evolution of financial markets, rapid changes in information technology, and the consequences for management and control, make it impossible to draw up an all-inclusive list of all situations when providing non-assurance services to an assurance client might create threats to independence and of the different safeguards that might eliminate these threats or reduce them to an acceptable level. In general, however, a firm may provide services beyond the assurance engagement provided any threats to independence have been reduced to an acceptable level.</p> <p><b>8.160</b> The following safeguards may be particularly relevant in reducing, to an acceptable level, threats created by the provision of non-assurance services to assurance clients:</p> <ul style="list-style-type: none"> <li>• Policies and procedures to prohibit professional staff from making management decisions for the assurance client, or assuming responsibility for such decisions;</li> <li>• Discussing independence issues related to the provision of non-assurance services with those charged with governance, such as the audit committee;</li> <li>• Policies within the assurance client regarding the oversight responsibility for provision of non-assurance services by the firm;</li> <li>• Involving an additional professional accountant to advise on the potential impact of the non-assurance engagement on the independence of the member of the assurance team and the firm;</li> <li>• Involving an additional professional accountant outside of the firm to provide assurance on a discrete aspect of the assurance engagement;</li> <li>• Obtaining the assurance client’s acknowledgement of responsibility for the results of the work performed by the firm;</li> <li>• Disclosing to those charged with governance, such as the audit committee, the nature and extent of fees charged; or</li> <li>• Making arrangements so that personnel providing non-assurance</li> </ul>

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<b>Text of EC Recommendation</b>	<b>Text of IFAC Code of Ethics</b>
	<p align="center">services do not participate in the assurance engagement.</p> <p><b>8.161</b> Before the firm accepts an engagement to provide a non-assurance service to an assurance client, consideration should be given to whether the provision of such a service would create a threat to independence. In situations when a threat created is other than clearly insignificant, the non-assurance engagement should be declined unless appropriate safeguards can be applied to eliminate the threat or reduce it to an acceptable level.</p> <p><b>8.162</b> The provision of certain non-assurance services to audit clients may create threats to independence so significant that no safeguard could eliminate the threat or reduce it to an acceptable level. However, the provision of such services to a related entity, division or discrete financial statement item of such clients may be permissible when any threats to the firm’s independence have been reduced to an acceptable level by arrangements for that related entity, division or discrete financial statement item to be audited by another firm or when another firm re-performs the non-assurance service to the extent necessary to enable it to take responsibility for that service.</p>
<p><b>Annex</b></p> <p>7.2. <u>Examples – Analysis of Specific Situations</u></p> <p>Business and financial markets are evolving continuously and information technologies are changing rapidly. These developments have significant consequences for management and control. With this state of change, it is not possible to draw up a comprehensive list of all those situations where the provision of non-audit services to an Audit Client would create a significant threat to statutory auditors’ independence. Neither is it possible to list the different safeguards which may exist to mitigate such threats. The examples which follow describe specific situations that could compromise a Statutory</p>	

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<p>Auditor’s independence. They also discuss the safeguards which may be appropriate to reduce the independence risk to an acceptable level in each circumstance. In practice, the Statutory Auditor will need to assess the implications of similar, but different circumstances, and to consider what safeguards would satisfactorily address the independence risk in the judgement of an informed third party.</p>	
<p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.1 Preparing accounting records and financial statements</u></p> <p>7.2.1.1 A self-review threat exists whenever a Statutory Auditor, an Audit Firm, an entity within a Network of firms or a Partner, manager or employee thereof participates in the preparation of the Audit Client’s accounting records or financial statements. The significance of the threat depends upon the spectrum of these persons’ involvement in the preparation process and upon the level of public interest.</p> <p>7.2.1.2. The significance of the self-review threat is always considered too high to allow a participation in the preparation process unless the assistance provided is solely of a technical or mechanical nature or the advice given is only of an informative nature.</p> <p>7.2.1.3. However, where Statutory Audits of Public Interest Entity clients are concerned, the provision of any such assistance other than that which is within the statutory audit mandate would be perceived to cause an unacceptably high level of independence risk, and should therefore be prohibited.</p>	<p><u>Preparing Accounting Records and Financial Statements</u></p> <p><b>8.163</b> Assisting an audit client in matters such as preparing accounting records or financial statements may create a self-review threat when the financial statements are subsequently audited by the firm.</p> <p><b>8.164</b> It is the responsibility of client management to ensure that accounting records are kept and financial statements are prepared, although they may request the firm to provide assistance. If firm, or network firm, personnel providing such assistance make management decisions, the self-review threat created could not be reduced to an acceptable level by any safeguards. Consequently, personnel should not make such decisions. Examples of such managerial decisions include the following:</p> <ul style="list-style-type: none"> <li>• Determining or changing journal entries, or the classifications for accounts or transaction or other accounting records without obtaining the approval of the audit client;</li> <li>• Authorizing or approving transactions; and</li> <li>• Preparing source documents or originating data (including decisions on valuation assumptions), or making changes to such documents or data.</li> </ul> <p><b>8.165</b> The audit process involves extensive dialogue between the firm and management of the audit client. During this process, management requests and receives significant input regarding such matters as accounting principles</p>

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<p><b>Annex</b></p> <p>7.2. <u>Examples – analysis of specific situations</u></p> <p>7.2.1 <u>Preparing accounting records and financial statements</u></p> <p><u>Spectrum of Involvement in the Preparation Process</u></p> <p>There is a spectrum of involvement by the Statutory Auditor (including his Audit Firm, Network member firms, or any employees thereof) in the preparation of accounting records and financial statements. At one end of the spectrum, the Statutory Auditor may prepare prime accounting records, do the bookkeeping and prepare the financial statements, as well as performing the Statutory Audit of these financial statements. In other cases, the Statutory Auditor helps his Audit Client in the preparation of the financial statements on the basis of the trial balance, assisting his Audit Client in the calculation of the closing entries (calculation of accruals, bad debts, depreciation, etc.). At the other end of the spectrum, the Statutory Auditor does not participate in any part of the preparation process. Even in the latter case, the Statutory Auditor who detects shortcomings in the Audit Client’s proposed disclosures will normally suggest and draft the amendments required. This is part of the Statutory Audit mandate and should not be considered as the provision of a non-audit service. While management always has responsibility for the presentation of the financial statements, the end result is that it is uncommon for a set of financial statements to appear where the Statutory Auditor has had no hand whatsoever in the presentation or drafting.</p> <p><u>Nature of Assistance and Advice</u></p> <p>The Audit Client and its management must be responsible for the financial statements and for maintaining accounting records. The Statutory Auditor’s safeguards must at least ensure that, when providing bookkeeping-related</p>	<p>and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. Technical assistance of this nature and advice on accounting principles for audit clients are an appropriate means to promote the fair presentation of the financial statements. The provision of such advice does not generally threaten the firm’s independence. Similarly, the audit process may involve assisting an audit client in resolving account reconciliation problems, analyzing and accumulating information for regulatory reporting, assisting in the preparation of consolidated financial statements (including the translation of local statutory accounts to comply with group accounting policies and the transition to a different reporting framework such as International Accounting Standards), drafting disclosure items, proposing adjusting journal entries and providing assistance and advice in the preparation of local statutory accounts of subsidiary entities. These services are a considered to be a normal part of the audit process and do not, under normal circumstances, threaten independence.</p> <p><u>General Provisions</u></p> <p><b>8.166</b> The examples in paragraphs 8.167 through 8.170 indicate that self-review threats may be created if the firm is involved in the preparation of accounting records or financial statements and those financial statements are subsequently the subject matter of an audit engagement of the firm. This notion may be equally applicable in situations when the subject matter of the assurance engagement is not financial statements. For example, a self-review threat would be created if the firm developed and prepared prospective financial information and subsequently provided assurance on this prospective financial information. Consequently, the firm should evaluate the significance of any self-review threat created by the provision of such services. If the self-review threat is other than clearly insignificant safeguards should be considered and applied as necessary to reduce the threat to an acceptable level.</p>

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<p>assistance, the accounting entries and any underlying assumptions (e.g. for valuation purposes) are originated by the client. In addition, the Statutory Auditor should not be involved in the decision-making of the Audit Client or its management in respect of the entries or assumptions.</p> <p>The Statutory Auditor’s assistance should therefore be limited to carrying out technical or mechanical tasks and to providing advisory information on alternative standards and methodologies which the Audit Client might wish to apply.</p> <p>Examples of assistance which compromise independence include the following:</p> <ul style="list-style-type: none"> <li>• Determining or changing journal entries, or the classifications for accounts or transactions, or other accounting records without obtaining the client’s approval;</li> <li>• Authorising or approving transactions; or</li> <li>• Preparing source documents or originating data (including decisions on valuation assumptions), or making changes to such documents or data.</li> </ul> <p>Examples of assistance which would not necessarily compromise independence could include:</p> <ul style="list-style-type: none"> <li>• Performing mechanical bookkeeping tasks, such as recording transactions for which the Audit Client’s management has determined the appropriate account classification; posting coded transactions to a client’s general ledger; posting client-approved entries to a client’s trial balance; or providing certain data-processing services;</li> <li>• Informing the client about applicable accounting standards or valuation methodologies for the client to decide which should be adopted.</li> </ul>	<p><u>Audit Clients that are not Listed Entities</u></p> <p><b>8.167</b> The firm, or a network firm, may provide an audit client that is not a listed entity with accounting and bookkeeping services, including payroll services, of a routine or mechanical nature, provided any self-review threat created is reduced to an acceptable level. Examples of such services include:</p> <ul style="list-style-type: none"> <li>• Recording transactions for which the audit client has determined or approved the appropriate account classification;</li> <li>• Posting coded transactions to the audit client’s general ledger;</li> <li>• Preparing financial statements based on information in the trial balance; and</li> <li>• Posting audit client approved entries to the trial balance.</li> </ul> <p>The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Making arrangements so such services are not performed by a member of the assurance team;</li> <li>• Implementing policies and procedures to prohibit the individual providing such services from making any managerial decisions on behalf of the audit client;</li> <li>• Requiring the source data for the accounting entries to be originated by the audit client;</li> <li>• Requiring the underlying assumptions to be originated and approved by the audit client; or</li> <li>• Obtaining audit client approval for any proposed journal entries or other changes affecting the financial statements.</li> </ul>

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<p><u>Level of Public Interest</u></p> <p>The self-review threat that arises when a Statutory Auditor assists in the preparation of the accounting records or financial statements of a Public Interest Entity is perceived to be so high that it cannot be mitigated by safeguards other than the prohibition of any such assistance that goes beyond the statutory audit mandate (i.e., any assistance other than the suggestion and drafting of amendments during the due course of the Statutory Audit, after having detected shortcomings in the Audit Client’s proposed disclosures).</p> <p>In any case, where the Statutory Auditor is asked to participate in the preparation of an Audit Client’s accounting records or financial statements, he should carefully consider the public perception in relation to his task. This may depend on the size and structure of the Audit Client as well as on the business environment in which this client operates at either a local, regional or national level. Where the threat is perceived to reach a level that would cause the public to question his independence, the Statutory Auditor should not accept the engagement.</p> <p><u>Emergency Situations</u></p> <p>In emergency cases, a Statutory Auditor may participate in the preparation process to an extent which would not be acceptable under normal circumstances (see 7.2.1.2 and 7.2.1.3 above). This might arise when, due to external and unforeseeable events, the Statutory Auditor is the only person with the resources and necessary knowledge of the Audit Client’s systems and procedures to assist the client in the timely preparation of its accounts and financial statements. A situation could be considered an emergency where the Statutory Auditor’s refusal to provide these services would result in a severe burden for the Audit Client (e.g., withdrawal of credit lines), or would even threaten its going concern status.</p>	<p><u>Audit Clients that are Listed Entities</u></p> <p><b>8.168</b> The provision of accounting and bookkeeping services, including payroll services and the preparation of financial statements or financial information which forms the basis of the financial statements on which the audit report is provided, on behalf of an audit client that is a listed entity, may impair the independence of the firm or network firm, or at least give the appearance of impairing independence. Accordingly, no safeguard other than the prohibition of such services, except in emergency situations and when the services fall within the statutory audit mandate, could reduce the threat created to an acceptable level. Therefore, a firm or a network firm should not, with the limited exceptions below, provide such services to listed entities which are audit clients.</p> <p><b>8.169</b> The provision of accounting and bookkeeping services of a routine or mechanical nature to divisions or subsidiaries of listed audit clients would not be seen as impairing independence with respect to the audit client provided that the following conditions are met:</p> <ul style="list-style-type: none"> <li>(a) The services do not involve the exercise of judgment;</li> <li>(b) The divisions or subsidiaries for which the service is provided are collectively immaterial to the audit client, or the services provided are collectively immaterial to the division or subsidiary; and</li> <li>(c) The fees to the firm, or network firm, from such services are collectively clearly insignificant.</li> </ul> <p>If such services are provided, all of the following safeguards should be applied:</p> <ul style="list-style-type: none"> <li>(a) The firm, or network firm, should not assume any managerial role nor make any managerial decisions;</li> <li>(b) The listed audit client should accept responsibility for the results of the</li> </ul>

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<p>In such an emergency situation, however, the Statutory Auditor should take no part in any final decisions and should seek the client’s approvals wherever possible. He should also consider additional safeguards that would allow him to minimise the level of risk to his independence. Where appropriate, he should seek to discuss the situation with the Audit Client’s Governance Body and ensure that the services he provided and the reasons for this are summarised in the financial statements.</p> <p><u>Statutory Audits on Consolidated Financial Statements of Public Interest Entities</u></p> <p>When the consolidated financial statements of a Public Interest Entity client are subject to a Statutory Audit, there might be situations where it is impractical for a subsidiary of such an Audit Client to make arrangements in accordance with (3) above. As a result, it is possible that its local auditor will have to participate in the preparation of financial statements that are to be included in the Audit Client’s consolidated financial statements. Under such circumstances, the self-review threat from the perspective of the Statutory Auditor of the Public Interest Entity client, is generally not considered to be significant, provided that the bookkeeping-related assistance is solely of a technical or mechanical nature or the advice is only of an informative nature (see (2) above), that the financial statements of such subsidiaries are not material to the Audit Client’s consolidated financial statements (neither separately nor in total), and that the fees the Audit Firm and its Network members receive for all such services collectively are insignificant in relation to the consolidated audit fee.</p>	<p>work; and</p> <p>(c) Personnel providing the services should not participate in the audit.</p> <p><u>Emergency Situations</u></p> <p><b>8.170</b> The provision of accounting and bookkeeping services to audit clients in emergency or other unusual situations, when it is impractical for the audit client to make other arrangements, would not be considered to pose an unacceptable threat to independence provided:</p> <p>(a) The firm, or network firm, does not assume any managerial role or make any managerial decisions;</p> <p>(b) The audit client accepts responsibility for the results of the work; and</p> <p>(c) Personnel providing the services are not members of the assurance team.</p>
<p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.2. Design and Implementation of Financial Information Technology Systems (FITS)</u></p>	<p><u>Provision of IT Systems Services to Audit Clients</u></p> <p><b>8.184</b> The provision of services by a firm or network firm to an audit client that</p>

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<p>7.2.2.1. The provision of services by the Statutory Auditor, the Audit Firm or an entity within its Network to an Audit Client that involve the design and implementation of financial information technology systems (FITS) used to generate information forming part of the Audit Client’s financial statements may give rise to a self-review threat.</p> <p>7.2.2.2. The significance of the self-review threat is considered too high to permit a Statutory Auditor, an Audit Firm or one of its group member firms to provide such FITS services unless:</p> <ul style="list-style-type: none"> <li>(a) The Audit Client’s management acknowledges in writing that they take responsibility for the overall system of internal control;</li> <li>(b) The Statutory Auditor has satisfied himself that the Audit Client’s management is not relying on the FITS work as the primary basis for determining the adequacy of its internal controls and financial reporting systems;</li> <li>(c) In the case of an FITS design project, the service provided involves design to specifications set by the Audit Client’s management; and</li> <li>(d) The FITS services do not constitute a “turn key” project (i.e., a project that consists of software design, hardware configuration and the implementation of both), unless the Audit Client or its management explicitly confirms in the written acknowledgement required under 7.2.2.2 (a) that they take responsibility for <ul style="list-style-type: none"> <li>(i) The design, implementation and evaluation process, including any decision thereon; and</li> <li>(ii) The operation of the system, including the data used or generated by the system.</li> </ul> </li> </ul> <p>These provisions shall not limit the services a Statutory Auditor, an Audit Firm or a member of its Network performs in connection with the assessment, design, and implementation of internal accounting controls and risk</p>	<p>involve the design and implementation of financial information technology systems that are used to generate information forming part of a client’s financial statements may create a self-review threat.</p> <p><b>8.185</b> The self-review threat is likely to be too significant to allow the provision of such services to an audit client unless appropriate safeguards are put in place ensuring that:</p> <ul style="list-style-type: none"> <li>(a) The audit client acknowledges its responsibility for establishing and monitoring a system of internal controls;</li> <li>(b) The audit client designates a competent employee, preferably within senior management, with the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system;</li> <li>(c) The audit client makes all management decisions with respect to the design and implementation process;</li> <li>(d) The audit client evaluates the adequacy and results of the design and implementation of the system; and</li> <li>(e) The audit client is responsible for the operation of the system (hardware or software) and the data used or generated by the system.</li> </ul> <p><b>8.186</b> Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the audit engagement and with different reporting lines within the firm.</p> <p><b>8.187</b> The provision of services by a firm or network firm to an audit client which involve either the design or the implementation of financial information technology systems that are used to generate information forming part of a client’s financial statements may also create a self-review threat. The significance of the threat, if any, should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.</p>

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<p>management controls, provided these persons do not act as an employee or perform management functions.</p> <p>7.2.2.3. In cases not prohibited under 7.2.2.2 the Statutory Auditor should consider whether additional safeguards are needed to mitigate a remaining self-review threat. In particular whether services that involve the design and implementation of financial information technology systems should only be provided by an expert team with different personnel (including engagement partner) and different reporting lines to those of the audit Engagement Team.</p> <p><b>Annex</b></p> <p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.2. Design and implementation of financial information technology systems</u></p> <p><u>Financial Information</u></p> <p>Statutory audit work includes the testing of those hardware and software systems that are used by the Audit Client to generate the financial information which is to be disclosed in its financial statements. Where a Statutory Auditor (including his Audit Firm, Network member firms, or any employees thereof) is involved in the design and implementation of such a financial information technology system (FITS), a self-review threat may arise. In this respect, financial information does not only include those figures which are directly disclosed in the financial statements, but also comprises any other valuation or physical data to which the financial statements’ disclosures relate. Such information is generated by either integrated IT-systems or a variety of stand-alone systems (e.g., systems for bookkeeping, cost-accounting, payroll, or cash management as well as those systems which may only provide physical numbers, such as some warehousing and production control systems, etc.).</p>	<p><b>8.188</b> The provision of services in connection with the assessment, design and implementation of internal accounting controls and risk management controls are not considered to create a threat to independence provided that firm or network firm personnel do not perform management functions.</p>

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<p><u>Spectrum of Involvement</u></p> <p>There is a spectrum of involvement by the Statutory Auditor in the design and implementation of FIT-systems:</p> <p>At one end of the spectrum, there are engagements where the Statutory Auditor takes on a management role or responsibilities for the FIT-systems design and implementation project as a whole, or for the operation of the FIT-system and the data it uses or generates. Such an engagement would clearly result in an unacceptable level of independence risk.</p> <p>In other cases, the Statutory Auditor must carefully assess the independence risk which might arise from his involvement in systems design and implementation for the Audit Client, particularly if there are public interest implications. In all cases he should consider whether there are appropriate safeguards to reduce the independence risk to an acceptable level. For example, the level of risk may be acceptable where the Statutory Auditor’s role is to provide advice to a consortium retained by the Audit Client to design and/or implement a project. Similarly, there is little risk in the case of a smaller company client, where the Statutory Auditor is asked to tailor a standard, off-the-shelf accounting system to meet the needs of that client’s business. However, independence risk may be perceived to be unacceptably high in the case of a design project for a large company or Public Interest Entity client.</p> <p>At the other end of the spectrum, the Statutory Auditor might be engaged to provide his Audit Client with a review of alternative systems. Based on this review the client himself decides which system to install. The provision of such a service would generally not compromise the Statutory Auditor’s independence, provided that cost and benefits of the systems reviewed are properly documented and discussed with the Audit Client. However, his independence will be compromised if the Statutory Auditor has a significant financial interest (see Chapter 1 – Financial Interests) or a significant business</p>	

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<p>relationship (see Chapter 2 – Business Relationships) with any of the systems’ suppliers.</p>	
<p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.3. Valuation Services</u></p> <p>7.2.3.1. A self-review threat exists whenever a Statutory Auditor, an Audit Firm, an entity within a Network or a Partner, manager or employee thereof provides the Audit Client with valuation services that result in the preparation of a valuation that is to be incorporated into the client’s financial statements.</p> <p>7.2.3.2. The significance of the self-review threat is considered too high to allow the provision of valuation services which lead to the valuation of amounts that are material in relation to the financial statements and where the valuation involves a significant degree of subjectivity inherent in the item concerned.</p> <p>7.2.3.3. In cases not prohibited under 7.2.3.2 the Statutory Auditor should consider whether additional safeguards are needed to mitigate a remaining self-review threat. In particular, where a valuation service should only be provided by an expert team with different personnel (including engagement partner) and different reporting lines to those of the audit Engagement Team.</p> <p><b>Annex</b></p> <p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.3. Valuation Services</u></p>	<p><u>Valuation Services</u></p> <p><b>8.171</b> A valuation comprises the making of assumptions with regard to future developments, the application of certain methodologies and techniques, and the combination of both in order to compute a certain value, or range of values, for an asset, a liability or for a business as a whole.</p> <p><b>8.172</b> A self-review threat may be created when a firm or network firms performs a valuation for an audit client that is to be incorporated into the client’s financial statements.</p> <p><b>8.173</b> If the valuation service involves the valuation of matters material to the financial statements and the valuation involves a significant degree of subjectivity, the self-review threat created could not be reduced to an acceptable level by the application of any safeguard. Accordingly, such valuation services should not be provided or, alternatively, the only course of action would be to withdraw from the audit engagement.</p> <p><b>8.174</b> Performing valuation services that are neither separately nor in the aggregate material to the financial statements, or that do not involve a significant degree of subjectivity, may create a self-review threat that could be reduced to an acceptable level by the application of safeguards. Such safeguards might include:</p>

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<p><u>Valuation Services</u></p> <p>A valuation comprises the making of assumptions with regard to future developments, the application of certain methodologies and techniques, and the combination of both in order to compute a certain value, or a range of values, for an asset, a liability or for a business as a whole. The underlying assumptions of such a valuation may relate to interpretations of the present or expectations of the future, including both general developments and the consequences of certain actions taken or planned by the Audit Client or anybody within its close business environment.</p> <p>Engagements to review or to issue an opinion on the valuation work performed by others (e.g. engagements under Articles 10 and 27 of the 2nd Company Law Directive [77/91/EEC], Articles 10 and 23 of the 3rd Company Law Directive [78/855/EEC], or under Article 8 of the 6th Company Law Directive [82/891/EEC]), or to collect and verify data to be used in a valuation performed by others (e.g., typical “due diligence” work in connection with the sale or purchase of a business), are not regarded as valuation services under this principle.</p> <p><u>Materiality and Subjectivity</u></p> <p>Valuation services leading to the valuation of amounts which neither separately nor in the aggregate are material in relation to the financial statements are not considered to create a significant threat to independence.</p> <p>The underlying assumptions of a valuation and the methodologies to be applied are always the responsibility of the Audit Client or its management. Therefore, as part of its decision-making process, the Audit Client or its management has generally to determine the underlying assumptions of the valuation, and to decide on the methodology to be applied for the computation of the value. This is of particular importance when the valuation to be</p>	<p align="center"><b>Text of IFAC Code of Ethics</b></p> <ul style="list-style-type: none"> <li>• Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary;</li> <li>• Confirming with the audit client their understanding of the underlying assumptions of the valuation and the methodology to be used and obtaining approval for their use;</li> <li>• Obtaining the audit client’s acknowledgement of responsibility for the results of the work performed by the firm; and</li> <li>• Making arrangements so that personnel providing such services do not participate in the audit engagement.</li> </ul> <p>In determining whether the above safeguards would be effective, consideration should be given to the following matters:</p> <ol style="list-style-type: none"> <li>(a) The extent of the audit client’s knowledge, experience and ability to evaluate the issues concerned, and the extent of their involvement in determining and approving significant matters of judgment;</li> <li>(b) The degree to which established methodologies and professional guidelines are applied when performing a particular valuation service;</li> <li>(c) For valuations involving standard or established methodologies, the degree of subjectivity inherent in the item concerned;</li> <li>(d) The reliability and extent of the underlying base data;</li> <li>(e) The degree of dependence on future events of a nature which could create significant volatility inherent in the amounts involved; and</li> <li>(f) The extent and clarity of the disclosures in the financial statements.</li> </ol> <p><b>8.175</b> When a firm, or a network firm, performs a valuation service for an audit client for the purposes of making a filing or return to a tax authority, computing an amount of tax due by the assurance client or for the purpose of tax planning this would not create a significant threat to independence because such valuations are generally subject to external review, for example by a tax authority.</p>

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<p>performed requires a significant degree of subjectivity, either in relation to the underlying assumptions or regarding the differences in applicable methodologies.</p> <p>However, with regard to certain routine valuations, the degree of subjectivity inherent in the item concerned may be insignificant. This is the case when the underlying assumptions are determined by law (e.g., tax rates, depreciation rates for tax purposes), other regulations (e.g., provision to use certain interest rates), or are widely accepted within the Audit Client’s business sector, and when the techniques and methodologies to be used are based on general accepted standards, or even prescribed by laws and regulations. In such circumstances, the result of a valuation performed by an informed third party, even if not identical, is unlikely to be materially different. The provision of such valuation services might therefore not compromise a statutory auditor’s independence, even if the value itself could be regarded as material to the financial statements, provided that the Audit Client or its management has at least approved all significant matters of judgement .</p> <p><u>Additional Safeguards</u></p> <p>Some valuation services involve an insignificant degree of subjectivity. These could include those requiring the application of standard techniques or methodologies or where the service is a review of the valuation methods used by a third party, but where the resulting valuation is material in relation to the financial statements. In these cases, the Statutory Auditor should consider whether there remains a self-review threat which should be mitigated by additional safeguards. It may be appropriate to address such a threat by setting up a valuation service team separate from the Engagement Team, with different reporting lines for both.</p>	<p><b>8.176</b> When the firm performs a valuation that forms part of the subject matter of an assurance engagement that is not an audit engagement, the firm should consider any self-review threats. If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.</p>

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<p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.4. Participation in the Audit Client’s Internal Audit</u></p> <p>7.2.4.1. Self-review threats may arise in certain circumstances where a Statutory Auditor, an Audit Firm or an entity within a Network provides internal audit services to an Audit Client.</p> <p>7.2.4.2. To mitigate self-review threats when involved in an Audit Client’s internal audit task, the Statutory Auditor should:</p> <p>(a) Satisfy himself that the Audit Client’s management or Governance Body is at all times responsible for</p> <p>(i) The overall system of internal control (i.e., the establishment and maintenance of internal controls, including the day to day controls and processes in relation to the authorisation, execution and recording of accounting transactions);</p> <p>(ii) Determining the scope, risk and frequency of the internal audit procedures to be performed; and</p> <p>(iii) Considering and acting on the findings and recommendations provided by internal audit or during the course of a Statutory Audit.</p> <p>If the Statutory Auditor is not satisfied that this is the case, neither he, nor the Audit Firm nor any entity within its Network should participate in the Audit Client’s internal audit.</p> <p>(b) Not accept the outcomes of internal auditing processes for statutory audit purposes without adequate review. This will include a subsequent reassessment of the relevant statutory audit work by an Audit Partner who</p>	<p><u>Provision of Internal Audit Services to Audit Clients</u></p> <p><b>8.178</b> A self-review threat may be created when a firm, or network firm, provides internal audit services to an audit client. Internal audit services may comprise an extension of the firm’s audit service beyond requirements of generally accepted auditing standards, assistance in the performance of a client’s internal audit activities or outsourcing of the activities. In evaluating any threats to independence, the nature of the service will need to be considered. For this purpose, internal audit services do not include operational internal audit services unrelated to the internal accounting controls, financial systems or financial statements.</p> <p><b>8.179</b> Services involving an extension of the procedures required to conduct an audit in accordance with International Standards on Auditing would not be considered to impair independence with respect to an audit client provided that the firm’s or network firm’s personnel do not act or appear to act in a capacity equivalent to a member of audit client management.</p> <p><b>8.180</b> When the firm, or a network firm, provides assistance in the performance of a client’s internal audit activities or undertakes the outsourcing of some of the activities, any self-review threat created may be reduced to an acceptable level by ensuring that there is a clear separation between the management and control of the internal audit by audit client management and the internal audit activities themselves.</p> <p><b>8.181</b> Performing a significant portion of the audit client’s internal audit activities may create a self-review threat and a firm, or network firm, should consider the threats and proceed with caution before taking on such activities. Appropriate safeguards should be put in place and the firm, or network firm, should, in particular, ensure that the audit client acknowledges its</p>

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<p>is involved neither in the Statutory Audit nor in the internal audit engagement.</p> <p><b>Annex</b></p> <p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.4. Participation in the Audit Client’s Internal Audit</u></p> <p>Internal Audit is an important element of an entity’s internal control system. In companies, particularly small and medium sized ones, which cannot afford an internal audit department or where such a department lacks certain facilities (e.g. access to specialists in information technology or treasury management), participation by the Statutory Auditor in the internal audit may strengthen management control capacities.</p> <p>However, self-review threats can arise if, for example, there is not a clear separation between the management and control of the internal audit and the internal audit activities themselves, or if the Statutory Auditor’s evaluation of his Audit Client’s internal control system determines the kind and volume of his subsequent statutory audit procedures. To avoid such threats, the Statutory Auditor, the Audit Firm or its Network member must be able to show that it is not involved in management and control of the internal audit. Furthermore, in his capacity as the statutory auditor of the client’s financial statements the Statutory Auditor must be able to demonstrate that he has taken appropriate steps to have the results of the internal audit work reviewed and has not placed undue reliance on these results in establishing the nature, timing and extent of his statutory audit work. In order to ensure that the Audit Firm’s statutory audit work meets required auditing standards and that the Statutory Auditor’s independence is not compromised, an appropriate review of these matters should be performed by an Audit Partner who has not been involved in either the Statutory Audit or any of the internal audit engagements which may impact</p>	<p>responsibilities for establishing, maintaining and monitoring the system of internal controls.</p> <p><b>8.182</b> Safeguards that should be applied in all circumstances to reduce any threats created to an acceptable level include ensuring that:</p> <ul style="list-style-type: none"> <li>(a) The audit client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the system of internal controls;</li> <li>(b) The audit client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;</li> <li>(c) The audit client, the audit committee or supervisory body approves the scope, risk and frequency of internal audit work;</li> <li>(d) The audit client is responsible for evaluating and determining which recommendations of the firm should be implemented;</li> <li>(e) The audit client evaluates the adequacy of the internal audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining and acting on reports from the firm; and</li> <li>(f) The findings and recommendations resulting from the internal audit activities are reported appropriately to the audit committee or supervisory body.</li> </ul> <p><b>8.183</b> Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the audit engagement and with different reporting lines within the firm.</p>

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<p>the financial statements.</p> <p>In companies where the internal audit department reports to a Governance Body rather than to management itself, the internal audit function performs a role that is complementary to the statutory audit function. It can therefore be seen as a separate element of the corporate governance framework. If the Statutory Auditor is asked to perform internal audit work in these circumstances, he must still be able to demonstrate that he has adequately assessed any threats to his independence, and has applied any necessary safeguards.</p>	
<p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.5. Acting for the audit client in the resolution of litigation</u></p> <p>7.2.5.1. An advocacy threat exists whenever a Statutory Auditor, an Audit Firm, an entity within a Network or a Partner, manager or employee thereof acts for the Audit Client in the resolution of a dispute or litigation. A self-review threat may also arise where such a service includes the estimation of the Audit Client’s chances in the resolution of litigation, and thereby affects the amounts to be reflected in the financial statements.</p> <p>7.2.5.2. The significance of both the advocacy and the self-review threat is considered too high to allow a Statutory Auditor, an Audit Firm, an entity within a Network or a partner, manager or employee thereof to act for an Audit Client in the resolution of litigation which involves matters that would reasonably be expected to have a material impact on the client’s financial statements and a significant degree of subjectivity inherent to the case concerned.</p> <p>7.2.5.3. In cases not prohibited under (7.2.5.2.) the Statutory Auditor should</p>	<p><u>Provision of Litigation Support Services to Audit Clients</u></p> <p><b>8.190</b> Litigation support services may include such activities as acting as an expert witness, calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute, and assistance with document management and retrieval in relation to a dispute or litigation.</p> <p><b>8.191</b> A self-review threat may be created when the litigation support services provided to an audit client include the estimation of the possible outcome and thereby affects the amounts or disclosures to be reflected in the financial statements. The significance of any threat created will depend upon factors such as:</p> <ul style="list-style-type: none"> <li>• The materiality of the amounts involved;</li> <li>• The degree of subjectivity inherent in the matter concerned; and</li> <li>• The nature of the engagement.</li> </ul>

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<p>consider whether additional safeguards are needed to mitigate a remaining advocacy threat. This could include using personnel (including engagement Partner) who are not connected with the audit Engagement Team and who have different reporting lines.</p> <p><b>Annex</b></p> <p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.5. Acting for the audit client in the resolution of litigation</u></p> <p><u>Advocacy and self-review threats</u></p> <p>In certain circumstances the Statutory Auditor, the Audit Firm, an entity within a Network or a Partner, manager or employee thereof will assist the Audit Client in the resolution of a dispute or litigation.</p> <p>A Statutory Auditor who acts for the Audit Client in the resolution of a dispute or litigation is generally perceived to take on an advocacy role which is incompatible with the responsibility of a Statutory Auditor to give an objective opinion on the financial statements. This advocacy threat is accompanied by a self-review threat when the assistance in the resolution of litigation also requires the Statutory Auditor to estimate chances of his Audit Client succeeding in the action if this could affect amounts to be reflected in the financial statements. A Statutory Auditor who is involved in the resolution of litigation has therefore to consider the significance of both the advocacy threat and the self-review threat.</p> <p>The advocacy threat is increased when the Statutory Auditor, the Audit Firm or a Network member firm takes an active role on behalf of the Audit Client to resolve disputes or litigation. It is less likely that this threat will become significant, when the Statutory Auditor is only required to give evidence to a</p>	<p>The firm, or network firm, should evaluate the significance of any threat created and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Policies and procedures to prohibit individuals assisting the audit client from making managerial decisions on behalf of the client;</li> <li>• Using professionals who are not members of the assurance team to perform the service; or</li> <li>• The involvement of others, such as independent experts.</li> </ul> <p><b>8.192</b> If the role undertaken by the firm, or network firm, involved making managerial decisions on behalf of the audit client the threats created could not be reduced to an acceptable level by the application of any safeguard. Therefore, the firm, or network firm, should not perform this type of service for an audit client.</p>

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<p>court or tribunal in a case in which the client is involved.</p> <p>Even when taking a relatively active role on behalf of the client, there can be other specific situations which are generally not seen to compromise a Statutory Auditor’s independence. Such situations could include, the representation of an Audit Client before the court or the tax administration in a case of tax litigation. They could also include advising the client and defending a particular accounting treatment in a situation where a Member State’s authority, securities regulator or review panel, or any other similar European or international body investigates the Audit Client’s financial statements. However, whatever the circumstances, the Statutory Auditor should analyse the specific situation and his particular involvement to carefully assess whether or not there is a significant risk to his independence.</p> <p><u>Materiality and subjectivity</u></p> <p>The provision of legal services to an Audit Client in connection with the resolution of a dispute or litigation does not usually create a significant threat to independence when these services involve matters that, either separately or in the aggregate, are not expected by a reasonable and informed third party to have any material impact on the financial statements.</p> <p>Acting as an advocate of the Audit Client is inherently subjective, but the degree of subjectivity varies depending upon the nature of the legal proceedings. During the course of an audit, the Statutory Auditor usually has the choice either to evaluate the outcome of a legal proceeding himself, or to rely on a confirmation provided by an external lawyer engaged by the client. The degree of subjectivity in both cases is governed by factors such as the competence of the lawyer, his compliance with ethical rules of the lawyers’ profession, and the given evidence, rather than whether or not the lawyer is an employee of the Audit Firm or of a third party law firm.</p>	

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<p>With respect to legal situations where the outcome of legal proceedings can be reasonably estimated on given evidence, the estimation of amounts affected by litigation should not lead to material differences between services provided by the Audit Firm or a third party law firm (e.g. litigation regarding employment contracts with staff, or certain tax proceedings).</p> <p>On the other hand, there might be situations that involve significant inherent subjectivity. There may also be situations where it is impossible to evaluate evidence in an objective manner due to the nature of the business relationship between the Statutory Auditor and the Audit Client (e.g. personal involvement of former or present management, non-executive directors, or shareholders). In such cases, the Statutory Auditor should ensure that he is not involved in the Audit Client’s actions in the resolution of litigation, except in minor cases where the matter concerned would not reasonably be expected to have a material impact on the financial statements.</p> <p><u>Additional Safeguards</u></p> <p>In circumstances not covered under 7.2.5.2, the Statutory Auditor should consider whether there remain threats to independence which have to be mitigated by additional safeguards. It might be appropriate to avoid the audit Engagement Team being involved in the litigation process by setting up different engagement teams with different reporting lines for the Statutory Audit and the legal services related to the litigation.</p>	
<p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.6. Recruiting Senior Management</u></p> <p>7.2.6.1. Where a Statutory Auditor, an Audit Firm, an entity within a Network</p>	<p><u>Recruiting Senior Management</u></p> <p><b>8.200</b> The recruitment of senior management for an assurance client, such as those</p>

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<p>or a Partner, manager or employee thereof is involved in the recruitment of senior or key staff for the Audit Client, different kinds of threats to independence may arise. These can include self-interest, trust or intimidation threats.</p> <p>7.2.6.2. Before accepting any engagement to assist in the recruitment of senior or key staff, the Statutory Auditor should assess the current and future threats to his independence which may arise. He should then consider appropriate safeguards to mitigate such threats.</p> <p>7.2.6.3. When recruiting staff to key financial and administrative posts, the significance of the threats to the Statutory Auditor’s independence increases. As such, the Statutory Auditor should carefully consider whether there might be circumstances where even the provision of a list of potential candidates for such posts may cause an unacceptable level of independence risk. Where Statutory Audits of Public Interest Entities are concerned the independence risk would be perceived too high to allow the provision of such a short-list.</p> <p>7.2.6.4. In any case, the decision as to who should be engaged should always be taken by the Audit Client.</p> <p><b>Annex</b></p> <p>7.2. <u>Examples – analysis of specific situations</u></p> <p><u>7.2.6. Recruiting Senior Management</u></p> <p>A Statutory Auditor who is asked to assist an Audit Client to recruit senior or key staff should first assess the threats to his independence which might arise from, for example, the role of the person to be recruited and the nature of the assistance sought. The need for careful assessment is highest where the person recruited is likely to have a significant role in the client’s financial</p>	<p>in a position to affect the subject of the assurance engagement, may create current or future self-interest, familiarity and intimidation threats. The significance of the threat will depend upon factors such as</p> <ul style="list-style-type: none"> <li>• The role of the person to be recruited; and</li> <li>• The nature of the assistance sought.</li> </ul> <p>The firm could generally provide such services as reviewing the professional qualifications of a number of applicants and provide advice on their suitability for the post. In addition the firm could generally produce a short-list of candidates for interview, provided it has been drawn up using criteria specified by the assurance client.</p> <p>The significance of the threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. In all cases, the firm should not make management decisions and the decision as to whom to hire should be left to the client.</p>

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<p>management processes and hence to have regular contact with the Statutory Auditor. However, threats such as self-interest and familiarity may arise from other appointments too.</p> <p>With regard to the nature of the assistance sought, an example of an acceptable service might include reviewing the professional qualifications of a number of applicants and giving an objective opinion on their suitability for a post. Another acceptable service might include the provision of a short-list of candidates for interview, provided that it has been drawn up using criteria specified by the client, rather than on the Statutory Auditor’s own judgement. In both cases, care would be needed to ensure that any opinion given about the candidates did not pre-empt the Audit Client’s decision. If the Statutory Auditor concludes that he cannot give the assistance requested without directly or indirectly participating in the Audit Client’s decision as to who should be appointed, he should decline to provide it.</p>	
	<p><u>Provision of Taxation Services to Audit Clients</u></p> <p><b>8.177</b> In many jurisdictions, the firm may be asked to provide taxation services to an audit client. Taxation services comprise a broad range of services, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes. Such assignments are generally not seen to create threats to independence.</p>
	<p><u>Provision of Legal Services to Audit Clients</u></p> <p><b>8.193</b> Legal services are defined as any services for which the person providing the services must either be admitted to practice before the Courts of the jurisdiction in which such services are to be provided or have the required legal training to practice law. Legal services encompass a wide and</p>

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	<p>diversified range of areas including both corporate and commercial services to clients, such as contract support, litigation, mergers and acquisition advice and support and the provision of assistance to clients’ internal legal departments. The provision of legal services by a firm, or network firm, to an entity that is an audit client may create both self-review and advocacy threats.</p> <p><b>8.194</b> Threats to independence need to be considered depending on the nature of the service to be provided, whether the service provider is separate from the assurance team and the materiality of any matter in relation to the entities’ financial statements. The safeguards set out in paragraph 8.160 may be appropriate in reducing any threats to independence to an acceptable level. In circumstances when the threat to independence cannot be reduced to an acceptable level the only available action is to decline to provide such services or withdraw from the audit engagement.</p> <p><b>8.195</b> The provision of legal services to an audit client which involve matters that would not be expected to have a material effect on the financial statements are not considered to create an unacceptable threat to independence.</p> <p><b>8.196</b> There is a distinction between advocacy and advice. Legal services to support an audit client in the execution of a transaction (e.g. contract support, legal advice, legal due diligence and restructuring) may create self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Such a service would not generally impair independence, provided that:</p> <ul style="list-style-type: none"> <li>(a) Members of the assurance team are not involved in providing the service, and</li> <li>(b) In relation to the advice provided, the audit client makes the ultimate decision or, in relation to the transactions, the service involves the execution of what has been decided by the audit client.</li> </ul>

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	<p><b>8.197</b> Acting for an audit client in the resolution of a dispute or litigation in such circumstances when the amounts involved are material in relation to the financial statements of the audit client would create advocacy and self-review threats so significant no safeguard could reduce the threat to an acceptable level. Therefore, the firm should not perform this type of service for an audit client.</p> <p><b>8.198</b> When a firm is asked to act in an advocacy role for an audit client in the resolution of a dispute or litigation in circumstances when the amounts involved are not material to the financial statements of the audit client, the firm should evaluate the significance of any advocacy and self-review threats created and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Policies and procedures to prohibit individuals assisting the audit client from making managerial decisions on behalf of the client; or</li> <li>• Using professionals who are not members of the assurance team to perform the service.</li> </ul> <p><b>8.199</b> The appointment of a partner or an employee of the firm or network firm as General Counsel for legal affairs to an audit client would create self-review and advocacy threats that are so significant no safeguards could reduce the threats to an acceptable level. The position of General Counsel is generally a senior management position with broad responsibility for the legal affairs of a company and consequently, no member of the firm or network firm should accept such an appointment for an audit client.</p>
	<p><u>Corporate Finance and Similar Activities</u></p> <p><b>8.201</b> The provision of corporate finance services, advice or assistance to an</p>

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	<p>assurance client may create advocacy and self-review threats. In the case of certain corporate finance services, the independence threats created would be so significant no safeguards could be applied to reduce the threats to an acceptable level. For example, promoting, dealing in, or underwriting of an assurance client’s shares is not compatible with providing assurance services. Moreover, committing the assurance client to the terms of a transaction or consummating a transaction on behalf of the client would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level. In the+ case of an audit client the provision of those corporate finance services referred to above by a firm or a network firm would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level.</p> <p><b>8.202</b> Other corporate finance services may create advocacy or self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Examples of such services include assisting a client in developing corporate strategies, assisting in identifying or introducing a client to possible sources of capital that meet the client specifications or criteria, and providing structuring advice and assisting a client in analysing the accounting effects of proposed transactions. Safeguards that should be considered include:</p> <ul style="list-style-type: none"> <li>• Policies and procedures to prohibit individuals assisting the assurance client from making managerial decisions on behalf of the client;</li> <li>• Using professionals who are not members of the assurance team to provide the services; and</li> <li>• Ensuring the firm does not commit the assurance client to the terms of any transaction or consummate a transaction on behalf of the client.</li> </ul>

**Appendix 1 – Chapter 8: Audit and Non-Audit Fees**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>8.1. <u>Contingent Fees</u></p> <p>8.1.1 Fee arrangements for audit engagements in which the amount of the remuneration is contingent upon the results of the service provided raise self-interest and advocacy threats which are considered to bear an unacceptable level of independence risk. It is therefore required that:</p> <p>(a) Audit engagements should never be accepted on a contingent fee basis; and</p> <p>(b) In order to avoid any appearance of contingency, the basis for the calculation of the audit fees must be agreed each year in advance. This should include scope for variation so as to take account of unexpected factors in the work.</p> <p><b>Annex</b></p> <p>8.1. <u>Contingent Fees</u></p> <p><u>Audit Fee Arrangements</u></p> <p>Statutory audit work performed in the public interest is inherently unsuitable for fee arrangements where the Statutory Auditor’s remuneration depends on either any performance figure of the Audit Client or the outcome of the audit itself. Audit fees that are fixed by any court or governmental body do not constitute contingent fees.</p>	<p><u>Contingent fees</u></p> <p><b>8.207</b> Contingent fees are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed. For the purposes of this section, fees are not regarded as being contingent if a court or other public authority has established them.</p> <p><b>8.208</b> A contingent fee charged by a firm in respect of an assurance engagement creates self-interest and advocacy threats that cannot be reduced to an acceptable level by the application of any safeguard. Accordingly, a firm should not enter into any fee arrangement for an assurance engagement under which the amount of the fee is contingent on the result of the assurance engagement.</p> <p><b>8.209</b> A contingent fee charged by a firm in respect of a non-assurance service provided to an assurance client may also create self-interest and advocacy threats. If the amount of the fee for a non-assurance engagement was agreed to, or contemplated, during an assurance engagement and was contingent on the result of that assurance engagement, the threats could not be reduced to an acceptable level by the application of any safeguard. Accordingly, the only acceptable action is not to accept such arrangements. For other types of contingent fee arrangements, the significance of the threats created will depend on factors such as:</p> <ul style="list-style-type: none"> <li>• The range of possible fee amounts;</li> <li>• The degree of variability;</li> <li>• The basis on which the fee is to be determined;</li> <li>• Whether the outcome or result of the transaction is to be reviewed by an independent third party; and</li> </ul>

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	<ul style="list-style-type: none"> <li>• The effect of the event or transaction on the assurance engagement.</li> </ul> <p>The significance of the threats should be evaluated and, if the threats are other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threats to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Disclosing to the audit committee, or others charged with governance, the extent of nature and extent of fees charged;</li> <li>• Review or determination of the final fee by an unrelated third party; or</li> <li>• Quality and control policies and procedures.</li> </ul>
<p>8.1. <u>Contingent Fees</u></p> <p>8.1.2. Threats to independence may also arise from contingent fee arrangements for non-audit services which the Statutory Auditor, the Audit Firm or an entity within its Network provides to an Audit Client or to one of its Affiliates. The Statutory Auditor’s safeguarding system (see A. Framework 4.3.2 The Audit Firm’s internal safeguarding system<sup>48</sup>) should therefore ensure that:</p> <p>(a) Such an arrangement is never concluded without first assessing the independence risk it might create and ensuring that appropriate safeguards are available to reduce this risk to an acceptable level; and</p> <p>(b) Unless the Statutory Auditor is satisfied that there are appropriate safeguards in place to overcome the independence threats, either the non-audit engagement must be refused or the Statutory Auditor must resign</p>	

<sup>48</sup> See Footnote 32 on page 88.

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<p>from the Statutory Audit to allow the acceptance of the non-audit work.</p> <p><b>Annex</b></p> <p>8.1. <u>Contingent Fees</u></p> <p><u>Non-Audit Fee Arrangements</u></p> <p>Self-interest, self-review and advocacy threats to a Statutory Auditor’s independence also arise when the fee for a non-audit engagement is dependent upon a contingent event. This applies to all contingent arrangements between the Statutory Auditor, the Audit Firm or an entity within its Network, and the Audit Client or any of its Affiliates. Dependency on a contingent event means, for example, that the fee depends in some way on the progress or outcome of the project or the attainment of a particular performance figure by the Audit Client (or its Affiliate).</p> <p>In assessing the extent to which contingent fee arrangements pose a threat to statutory auditor independence, and the availability of suitable safeguards, the Statutory Auditor should consider amongst other factors: the relationship between the activity for which the contingent fee is to be paid, and the conduct of any current or future audit; the range of possible fee amounts; and the basis on which the fee is to be calculated.</p>	
<p>In performing this assessment, the Statutory Auditor should consider, inter alia, whether the amount of the contingent fee is directly determined by reference to an asset or transaction value (e.g., percentage of acquisition price) or a financial condition (e.g., growth in market capitalisation) the measurement of which will be subsequently exposed to an audit examination and whether this</p>	

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<p>increases the self-interest threat to unacceptable levels. On the other hand, independence threats will generally not arise in situations where there is no direct link between the basis of the contingent fee (e.g., the starting salary of a new employee when a recruitment service is provided) and a significant aspect of the audit engagement. Where a Governance Body exists, the Statutory Auditor should disclose contingent fee arrangements to that body in accordance with the principles set out under Section A. Framework 4.1.2. Involvement of the Governance Body<sup>49</sup>.</p>	
<p><b>Annex</b></p> <p>8.2. <u>Relationship between total fees and total revenue</u></p> <p>Excessive dependence on audit and non-audit fees from one Audit Client or one client group clearly gives rise to a self-interest threat to the Statutory Auditor’s independence. The Statutory Auditor or the Audit Firm has not only to avoid dependency but also has to consider carefully whether the appearance of such a dependency might create a significant threat to independence.</p> <p>8.2. <u>Relationship between total fees and total revenue</u></p> <p>8.2.1. The rendering of any (audit and non-audit) services by a Statutory Auditor, an Audit Firm or a Network to one Audit Client or its Affiliates should not be allowed to create a financial dependency on that Audit Client or client group, either in fact or in appearance.</p> <p>8.2.2. A financial dependency is considered to exist when the total (audit and</p>	<p><u>Fees – Relative size</u></p> <p><b>8.203</b> When the total fees generated by an assurance client represent a large proportion of a firm’s total fees, the dependence on that client or client group and concern about the possibility of losing the client may create a self-interest threat. The significance of the threat will depend upon factors such as:</p> <ul style="list-style-type: none"> <li>• The structure of the firm; and</li> <li>• Whether the firm is well established or newly created.</li> </ul> <p>The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:</p>

<sup>49</sup> See Footnote 46 on page 113.

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<p>non-audit) fees that an Audit Firm, or a Network receives or will receive from one Audit Client and its Affiliates make up an unduly high percentage of the total revenues in each year over a five-year period.</p> <p><b>Annex</b></p> <p>8.2. <u>Relationship between total fees and total revenue</u></p> <p><u>Appearance of financial dependency</u></p> <p>The Statutory Auditor, the Audit Firm or a Network might be perceived to be financially dependent on a single Audit Client or client group when the total audit and non-audit fee that it receives, or expects to receive, from that client or client group exceeds a critical percentage of its total income. The public perception of this critical percentage will depend upon different factors within the audit environment. For example, the level might be different depending on the size of the firm, whether it is well established or newly created, whether it operates locally, nationally or internationally, and on the general business situation in markets in which it is operating.</p>	<ul style="list-style-type: none"> <li>• Discussing the extent and nature of fees charged with the audit committee, or others charged with governance;</li> <li>• Taking steps to reduce dependency on the client;</li> <li>• External quality control reviews; and</li> <li>• Consulting a third party, such as a professional regulatory body or another professional accountant.</li> </ul> <p><b>8.204</b> A self-interest threat may also be created when the fees generated by the assurance client represent a large proportion of the revenue of an individual partner. The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguard might include:</p> <ul style="list-style-type: none"> <li>• Policies and procedures to monitor and implement quality control of assurance engagements; and</li> <li>• Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary.</li> </ul>

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<p>These circumstances have to be carefully considered by the Statutory Auditor when he assesses the significance of the self-interest threat to his appearance of independence. An analysis should be performed of all fees received for audit and non-audit services from a particular client or client group compared to the firm’s or Network’s total income, as well as of the relevant amounts that are expected to be received during the current firm’s or Network’s reporting period. If this analysis indicates a level of dependency and a need for safeguards, an Audit Partner who has not been engaged in any of the audit or non-audit work for the client should carry out a review of the significant audit and non-audit work done for the client and advise as necessary. The review should also take into consideration any audit and non-audit work that has been contracted or is the subject of an outstanding proposal. Where doubts remain, or where, because of the size of the firm, no such partner is available, the Statutory Auditor should seek the advice of his professional regulatory body or a review by another statutory auditor.</p> <p>8.2. <u>Relationship between total fees and total revenue</u></p> <p>8.2.3. The Statutory Auditor should also consider whether there are certain fee relationships with one Audit Client and its Affiliates which may appear to create a financial dependency in respect of a person who is in a position to influence the outcome of the Statutory Audit (any person within the scope of A. Framework 2 Responsibility and Scope<sup>50</sup>).</p>	

<sup>50</sup> See Footnote 2 on page 19.

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Text of EC Recommendation	Text of IFAC Code of Ethics
<p><b>Annex</b></p> <p>8.2. <u>Relationship between total fees and total revenue</u></p> <p><u>Certain other fee relationships</u></p> <p>The Statutory Auditor should also consider whether there are, or appear to be, other types of fee relationships between a single Audit Client or client group and himself or the Audit Firm that may cause a self-interest threat. For example, an Audit Partner within an office or branch might be perceived to be dependent on fees from a certain Audit Client, if most of that office’s services are provided to that Audit Client, or if the same individual is responsible for selling both audit and non-audit engagements to the Audit Client. To mitigate such self-interest threats, an Audit Firm may reconsider its organisational structures and the responsibilities of certain individuals, or, where applicable, discuss the way services are provided and charged with the Audit Client’s Governance Body.</p> <p>Independence may particularly be compromised when significant fees are generated from the provision of non-audit services to an Audit Client or its Affiliates. The Statutory Auditor should therefore assess this risk to his independence. In particular, he should consider the nature of the non-audit services provided, the different fees generated from the statutory audit engagement and the non-audit engagements, and their respective relationship to the total fees received by the Audit Firm or Network. If the analysis indicates the need for safeguards, particularly when the non-audit fees exceed the audit fees, an Audit Partner who is not involved in any of the audit and non-audit engagements should carry out a review of the work done for the client and advise as necessary.</p>	

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<p>8.2. <u>Relationship between total fees and total revenue</u></p> <p>8.2.4. In any case, the Statutory Auditor, the Audit Firm or the Network should be able to demonstrate that no financial dependency exists in relation to a particular Audit Client or its Affiliates</p>	
<p>8.3. <u>Overdue fees</u></p> <p>Where fees for audit or other work become significantly overdue and the sum outstanding, or that sum together with fees for current assignments could be regarded as a significant loan (see also Chapter 2 – Business Relationships), the self-interest threat to independence is considered to be so significant that a Statutory Auditor should not accept reappointment or, where appropriate and practicable, should resign from the current audit engagement. The situation should be reviewed by a Partner not involved in the provision of any services to the client. Where such a review cannot be performed, the situation should be subjected to an external review by another statutory auditor. Alternatively, advice should be sought from a professional regulatory body.</p> <p><b>Annex</b></p> <p>8.3. <u>Overdue fees</u></p> <p>Unpaid fees for audit or other work could appear to be in effect a loan from the Statutory Auditor to the Audit Client. This could threaten the Statutory Auditor’s independence by creating a mutual financial interest with the Audit Client. In such circumstances, a Statutory Auditor must assess the level of the threat and take any action that may be necessary. This could include disclosing the extent of the potential mutual interest to all relevant third parties. Where</p>	<p><u>Fees - Overdue</u></p> <p><b>8.205</b> A self-interest threat may be created if fees due from an assurance client for professional services remain unpaid for a long time, especially if a significant part is not paid before the issue of the assurance report for the following year. Generally the payment of such fees should be required before the report is issued. The following safeguards may be applicable:</p> <ul style="list-style-type: none"> <li>• Discussing the level of outstanding fees with the audit committee, or others charged with governance; and</li> <li>• Involving an additional professional accountant who did not take part in the assurance engagement to provide advice or review the work performed.</li> </ul> <p>The firm should also consider whether the overdue fees might be regarded as being equivalent to a loan to the client and whether, because of the significance of the overdue fees, it is appropriate for the firm to be reappointed.</p>

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<p>the Statutory Auditor is an Audit Firm, the circumstances may be reviewed by another Audit Partner who has not been involved in the provision of any services to the Audit Client. In the case of a sole practitioner, or a small partnership where all the Audit Partners have been involved with the Audit Client, the Statutory Auditor should either seek advice from his professional regulatory body or ask for a review by another statutory auditor.</p>	
<p>8.4. <u>Pricing</u></p> <p>A Statutory Auditor must be able to demonstrate that the fee for an audit engagement is adequate to cover the assignment of appropriate time and qualified staff to the task and compliance with all auditing standards, guidelines and quality control procedures. He should also be able to demonstrate that the resources allocated are at least those which would be allocated to other work of a similar nature.</p> <p><b>Annex</b></p> <p>8.4. <u>Pricing</u></p> <p>A Statutory Auditor must be able to demonstrate that the fee he charges for any audit engagement is reasonable, particularly if it is significantly lower than that charged by a predecessor or quoted by other firms bidding for the engagement. He must also be able to demonstrate that a quoted audit fee is not dependent on the expected provision of non-audit services, and that a client has not been misled as to the basis on which future audit and non-audit fees would be charged when negotiating the current audit fees. The Statutory Auditor should have policies and procedures in place to be able to demonstrate that his fees meet these requirements. Where Statutory Audits of Public Interest Entities are concerned, the Statutory Auditor should seek to discuss the basis</p>	<p><u>Pricing</u></p> <p><b>8.206</b> When a firm obtains an assurance engagement at a significantly lower fee level than that charged by the predecessor firm, or quoted by other firms, the self-interest threat created will not be reduced to an acceptable level unless:</p> <ul style="list-style-type: none"> <li>(a) The firm is able to demonstrate that appropriate time and qualified staff are assigned to the task; and</li> <li>(b) All applicable assurance standards, guidelines and quality control procedures are being complied with.</li> </ul>

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for calculating the audit fee with the Governance Body.	
	<b>8.210</b> Accepting gifts or hospitality from an assurance client may create self-interest and familiarity threats. When a firm or a member of the assurance team accepts gifts or hospitality, unless the value is clearly insignificant, the threats to independence cannot be reduced to an acceptable level by the application of any safeguard. Consequently, a firm or a member of the assurance team should not accept such gifts or hospitality.

**Appendix 1 – Chapter 9: Litigation**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>9.1. Both a self-interest and an advocacy threat may arise where litigation takes place, or appears likely to take place, between the Statutory Auditor, the Audit Firm or any other person being in a position to influence the outcome of the Statutory Audit (any person within the scope of A. Framework 2 Responsibility and Scope<sup>51</sup>) and an Audit Client or its Affiliates. All of the audit and non-audit services provided to the client have to be considered in order to assess these threats.</p> <p>9.2. Where the Statutory Auditor sees that such a threat may arise, he should discuss the case with the Audit Client’s Governance Body or, where such a body does not exist, with his professional regulatory body. The threats to the Statutory Auditor’s independence are likely to become significant where there is a serious likelihood of litigation which is material to any of the parties involved, or of litigation which calls into question a prior Statutory Audit, or where material litigation is in progress. The Statutory Auditor should cease to act as soon as such circumstances become evident, subject to the requirements of national law.</p> <p><b>Annex</b></p> <p>Whilst it is not possible to specify precisely for all cases the point at which it would become improper for a statutory auditor to continue as Statutory Auditor of an Audit Client, the following criteria should be considered:</p> <ul style="list-style-type: none"> <li>• If an Audit Client alleges deficiencies in statutory audit work, and the Statutory Auditor concludes that it is probable that a claim will be filed, the Statutory Auditor should first discuss the basis of the allegations with the Governance Body of the Audit Client or, where such body does</li> </ul>	<p><u>Actual or Threatened Litigation</u></p> <p><b>8.211</b> When litigation takes place, or appears likely, between the firm or a member of the assurance team and the assurance client, a self-interest or intimidation threat may be created. The relationship between client management and the members of the assurance team must be characterized by complete candor and full disclosure regarding all aspects of a client’s business operations. The firm and the client’s management may be placed in adversarial positions by litigation, affecting management’s willingness to make complete disclosures and the firm may face a self-interest threat. The significance of the threat created will depend upon such factors as:</p> <ul style="list-style-type: none"> <li>• The materiality of the litigation;</li> <li>• The nature of the assurance engagement; and</li> <li>• Whether the litigation relates to a prior assurance engagement.</li> </ul> <p>Once the significance of the threat has been evaluated the following safeguards should be applied, if necessary, to reduce the threats to an acceptable level:</p> <ol style="list-style-type: none"> <li>(a) Disclosing to the audit committee, or others charged with governance, the extent and nature of the litigation;</li> <li>(b) If the litigation involves a member of the assurance team, removing that individual from the assurance team; or</li> <li>(c) Involving an additional professional accountant in the firm who was not a member of the assurance team to review the work done or otherwise advise as necessary.</li> </ol>

<sup>51</sup> See Footnote 2 on page 19.

**Appendix 1 – Chapter 9: Litigation**

<b>Text of EC Recommendation</b>	<b>Text of IFAC Code of Ethics</b>
<p>not exist, with his professional regulatory body. If this confirms the judgment that it is probable that a claim will be filed, then - subject to local legal requirements - the Statutory Auditor should resign;</p> <ul style="list-style-type: none"> <li>• If the Statutory Auditor alleges fraud or deceit by current management of an Audit Client, the level of independence risk and the decision as to whether or not he should resign also depends on safeguards such as discussion of all relevant aspects with the Governance Body of the client, or, where such a body does not exist, with the Statutory Auditor’s professional regulatory body. (In some countries, however, the national law safeguards the independence of the Statutory Auditor in cases of alleged fraud by requiring the Statutory Auditor to report the detected fraud to a national authority and to continue his audit work on behalf of that authority which represents the national public interest. In any case the Statutory Auditor should consider seeking legal advice, giving due consideration to his responsibility to the public interest.);</li> <li>• Threatened or actual litigation relating to non-audit services for an amount not material to the Statutory Auditor or to the Audit Client (for example, claims out of disputes over billing for services, results of consultancy services) would not compromise the Statutory Auditors independence.</li> </ul>	<p>If such safeguards do not reduce the threat to an appropriate level, the only appropriate action is to withdraw from, or refuse to accept, the assurance engagement.</p>

**Appendix 1 – Chapter 10: Senior Personnel acting for a long period of time**

<b>Text of EC Recommendation</b>	<b>Text of IFAC Code of Ethics</b>
<p>10.1. Trust or familiarity threats may arise where certain members of the Engagement Team work regularly and for a long period of time on an Audit Client engagement, particularly where Public Interest Entity Audit Clients are concerned.</p>	<p><u>Long Association of Senior Personnel with Assurance Clients</u></p> <p>General Provisions</p> <p><b>8.150</b> Using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threat. The significance of the threat will depend upon factors such as:</p> <ul style="list-style-type: none"> <li>• The length of time that the individual has been a member of the assurance team;</li> <li>• The role of the individual on the assurance team;</li> <li>• The structure of the firm; and</li> <li>• The nature of the assurance engagement.</li> </ul> <p>The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied to reduce the threat to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>▪ Rotating the senior personnel off the assurance team;</li> <li>▪ Involving an additional professional accountant who was not a member of the assurance team to review the work done by the senior personnel or otherwise advise as necessary; or</li> <li>▪ Independent internal quality reviews.</li> </ul>

**Appendix 1 – Chapter 10: Senior Personnel acting for a long period of time**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p>10.2. To mitigate these threats, where the audit of a Public Interest Entity is concerned, the Statutory Auditor is required:</p> <p>(a) As a minimum to replace the Key Audit Partners<sup>52</sup> of the Engagement Team (including the Engagement Partner) within 7 years of appointment to the Engagement Team. The replaced Key Audit Partners should not be allowed to return to the Audit Client engagement until at least a two years period has elapsed since the date of their replacement; and</p> <p><b>Annex</b></p> <p>To mitigate a familiarity or trust threat to the independence of a Statutory Auditor who is engaged to audit an Audit Client of public interest, the requirement to replace the Engagement Partner and the other Key Audit Partners of the Engagement Team within a reasonable period of time cannot be replaced by other safeguards.</p> <p>When any member of an Engagement Team is replaced because of time served on a particular audit, or because of a related familiarity or trust threat, that individual should not be re-assigned to the team until at least two years have elapsed since his replacement.</p>	<p><u>Audit Clients that are Listed Entities</u></p> <p><b>8.151</b> Using the same lead engagement partner on an audit over a prolonged period may create a familiarity threat. This threat is particularly relevant in the context of the audit of listed entities and safeguards should be applied in such situations to reduce such threat to an acceptable level. Accordingly for the audit of listed entities:</p> <p>(a) The lead engagement partner should be rotated after a pre-defined period, normally no more than seven years; and</p> <p>(b) A partner rotating after a pre-defined period should not participate in the audit engagement until a further period of time, normally two years, has elapsed.</p>
	<p><b>8.152</b> When an audit client becomes a listed entity the length of time the lead engagement partner has served the audit client in that capacity should be considered in determining when the partner should be rotated. However, the partner may continue to serve as the lead engagement partner for two additional years before rotating off the engagement.</p>

<sup>52</sup> Defined in the Glossary and Definitions in Appendix 1.

**Appendix 1 – Chapter 10: Senior Personnel acting for a long period of time**

Text of EC Recommendation	Text of IFAC Code of Ethics
	<p><b>8.153</b> While the lead engagement partner should be rotated after such a pre-defined period, some degree of flexibility over timing of rotation may be necessary in certain circumstances. Examples of such circumstances include:</p> <ul style="list-style-type: none"> <li>▪ Situations when the lead engagement partner’s continuity is especially important to the audit client, for example, when there will be major changes to the audit client’s structure that would otherwise coincide with the rotation of the lead engagement partner; and</li> <li>▪ Situations when, due to the size of the firm, rotation is not possible or does not constitute an appropriate safeguard.</li> </ul> <p>In all such circumstances when the lead engagement partner is not rotated after such a pre-defined period equivalent safeguards should be applied to reduce any threats to an acceptable level.</p> <p><b>8.154</b> When a firm has only a few audit partners with the necessary knowledge and experience to serve as lead engagement partner on an audit client that is a listed entity, rotation of the lead partner may not be an appropriate safeguard. In these circumstances the firm should apply other safeguards to reduce the threat to an acceptable level. Such safeguards would include involving an additional professional accountant who was not otherwise associated with the assurance team to review the work done or otherwise advise as necessary. This individual could be someone from outside the firm or someone within the firm who was not otherwise associated with the assurance team.</p>
<p>10.2.</p> <p>(b) To consider the independence risk which may arise in relation to the prolonged involvement of other Engagement Team members, and to adopt appropriate safeguards to reduce it to an acceptable level.</p>	

**Appendix 1 – Chapter 10: Senior Personnel acting for a long period of time**

Text of EC Recommendation	Text of IFAC Code of Ethics
<p><b>Annex</b></p> <p>The Statutory Auditor should also consider the independence risk arising from the prolonged involvement of other members of the Engagement Team, including the senior staff engaged on audits of entities which are consolidated into an Audit Client’s consolidated financial statements, and from the composition of the team itself. He should apply safeguards, such as rotation and measures under the Audit Firm’s quality assurance scheme, to seek to ensure that the engagement may be properly continued without compromising his independence.</p>	
<p>10.3. Where Audit Clients other than Public Interest Entities are concerned, it is preferable that the procedures set out at 10.2 above should also apply. However, where the Audit Firm is unable to provide for rotation of Key Audit Partners, the Statutory Auditor should determine what other safeguards should be adopted to reduce the independence risk to an acceptable level.</p> <p><b>Annex</b></p> <p>There might be situations, where due to the size of the Audit Firm internal rotation of the Engagement Partner and other Key Audit Partners is not possible or may not constitute an appropriate safeguard. For example, in the case of a sole practitioner’s practice, or where the day to day relationship between a limited number of Audit Partners is too close. In such situations, the Statutory Auditor should ensure that other safeguards are put in place within a reasonable period of time. Such safeguards could include having the relevant audit engagement covered by an external quality review, or, as a minimum, seeking the advice of his professional regulatory body. If no suitable safeguards can be identified, the Statutory Auditor should consider whether it is appropriate to continue the audit engagement.</p>	

**Appendix 2 – Chapter 1: Financial Interests – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

EC Recommendation	IFAC Code of Ethics	Comments on the differences
	<p>The IFAC Code of Ethics on financial interests is much longer as it gives slightly differing advice on audit and non-audit assurance engagements. It can be summarised as:</p>	
<p>An actual or impending financial interest in the auditor or its affiliates may be a threat.</p>	<p>A financial interest in the assurance client may be a threat.</p>	<p>In terms of discussion of the threats posed by financial interests, an impending financial interest is not directly considered by the IFAC Code of Ethics. Not considered significant as any such circumstance would be covered by the framework approach.</p>
<p>Neither the firm, nor those in a position to influence the outcome of the audit (including partners in key offices) should have any direct, or any significant (to either party) indirect interest in the audit client / significant affiliates.</p>	<p>Neither the firm, nor those in a position to influence the outcome (including partners in the lead office and providers of significant non-assurance services, for audit clients only) should have any direct, or any material indirect interest in the assurance client.</p> <p>This is extended to the firm’s network for audit clients only.</p>	<p>There are certain general definition differences between the documents in terms of who is covered. Subject to that, the scope is broadly similar for audit clients, though the IFAC Code of Ethics extends it to providers of significant non-assurance services.</p> <p>The apparent differences from use of the words ‘significant’ and ‘material’ are not considered significant (or material) in practice. Neither is the fact that only the EC Recommendation refers to significant being considered from both parties point of view. This follows from the framework approach.</p> <p>The EC Recommendation does not consider the affiliates of the audit firm. The IFAC Code of Ethics is therefore, in this respect, tighter.</p>

<b>Appendix 2 – Chapter 1: Financial Interests – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
Chapter 6 separately extends this to close family members with significant financial interests.	The guidance includes immediate family members. The potential threat of holdings by close family members should also be considered.	The use by the IFAC Code of Ethics of two tiers of family leads to a slightly different emphasis on the threat posed by holdings by certain family members.
Any such interest acquired must be disposed of as soon as possible, maximum one month. Additional safeguards until then.	Any such interest acquired must be disposed of as soon as possible. Additional safeguards until then.	The IFAC Code of Ethics specifically indicates that reducing a material indirect holding to an immaterial level is acceptable. Not considered by the EC Recommendation. Not considered significant as any such circumstance would be covered by the framework approach.
The potential threat of insignificant interests should also be assessed, particularly if not acquired on standard commercial terms or on an arms length basis.		The potential threat of insignificant holdings is not directly addressed by the IFAC Code of Ethics. Not considered significant as any such circumstance would be covered by the framework approach.
Direct financial interests can include shareholdings, bonds, options, holding or dealing in securities, pension rights or other benefits, commitments and derivatives in respect of the above.	Includes a definition of financial interests, which covers equities, other securities, debt instruments, and rights and obligations and derivatives in respect of such interests.  Direct holdings are defined to include direct ownership and control, and beneficial holdings through other means.	The EC Recommendation's definition of financial interests is slightly broader than that in the IFAC Code of Ethics. Not considered significant as any such circumstance would be covered by the framework approach.  Of more note is the difference in considering what interests are direct and what indirect. The EC Recommendation focuses on the investment itself: whether it is directly with the client or not. The IFAC

**Appendix 2 – Chapter 1: Financial Interests – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
		Code of Ethics is more concerned with the substance of whether the investment gives control or not. In practice, the answer would generally be the same, but there would be differences at the margins, which would give different answers in respect of holdings that are not material.
Indirect financial interests can include holdings in entities with investments in clients, or in entities in which the client has investments, or where the auditor is a voting trustee or executor (there may be supervision and control safeguards available in the latter cases).	<p>Indirect financial interests are those where the holder has no ability to exercise control via the holding.</p> <p>Significant interests in entities with a controlling interest in a client should be taken into account, network interests being considered for audit clients only.</p> <p>The threat of retirement plans having holdings in audit clients also needs to be considered.</p> <p>Material interests in entities in which the client also has an influential interest should be taken into account for audit clients only.</p> <p>Acting as a trustee is only permissible if not a beneficiary, the trusts interest is immaterial and there is no significant influence over the investment decision.</p>	<p>Despite the slightly different approaches to the difference between direct and indirect holdings, the substance of the guidance on holdings in entities with investments in clients, or in entities in which the client has investments, is similar for audit clients.</p> <p>The comments on pension rights and plans are different (the EC Recommendation considers pension rights with the client, whereas the IFAC Code of Ethics considers pension plans with investments in the client) are slightly different and might warrant further guidance.</p> <p>The safeguards considered in respect of non-beneficiary trustee auditors are also different.</p>
Holdings through collective investment schemes are unlikely to be a threat where there is no direct involvement in auditing or decision making of the fund manager.	Holdings through collective investment schemes are examples of interests where there is no direct control.	Unlike the EC Recommendation, the IFAC Code of Ethics does not specifically state that holdings through collective investment schemes are unlikely to be a threat where there is no direct involvement in auditing or

**Appendix 2 – Chapter 1: Financial Interests – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
		decision making of the fund manager. It could, however, be considered to imply it through its discussion of the nature of the interest and the EC Recommendation follows logically from the framework approach.
Inadvertent violations are not unacceptable if there are established reporting procedures, the interests are disposed of as soon as possible and the work is carefully reviewed.	Inadvertent violations are not unacceptable if there are established reporting procedures, the interests are disposed of as soon as possible and the work is carefully reviewed.	The guidance on inadvertent violations is virtually identical.

**Appendix 2 – Chapter 2: Business Relationships – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>A business relationship between the firm or those in a position to influence, and the client or its affiliates or its management, may result in a threat.</p>	<p>A close business relationship between the firm (or network firm in the case of audit clients) or those in a position to influence, and the client or its management, may result in a threat.</p>	<p>The description of the threats posed by business relationships is similar, subject to the generic differences in the scope definitions.</p>
<p>Such relationships, actual or committed, are prohibited unless in normal course of business and at arms length, and insignificant (from the viewpoint of a reasonable and informed third party) in terms of threat. In cases of doubt about the latter, this should be discussed with the governance body.</p>	<p>Such relationships are prohibited (including to the network in case of audit clients) unless immaterial and the relationship is clearly insignificant to the parties.</p> <p>Dealings in normal course of business and at arms length would not normally be a threat. This could be discussed with the governance body.</p> <p>Relationships involving an interest in a closely held entity in which an audit client or senior management also have an interest will not be a threat if immaterial, the relationship is insignificant and there is no ability to control.</p>	<p>Committed business relationships are not directly considered by the IFAC Code of Ethics, which dwells only on current relationships. Not considered significant as any such circumstance would be covered by the framework approach.</p> <p>The EC Recommendation’s prohibition is more restrictive: to be exempt from the prohibition in the IFAC Code of Ethics, the relationship needs to be immaterial and insignificant to the parties. To be exempt from the prohibition in the EC Recommendation, the relationship effectively needs to be all of the above, and in the normal course of business.</p>
<p>Neither the audit firm nor its network should provide audit services to owners of the audit firm or an affiliate of such an owner where there is significant influence, or any other entity with senior management in a position to influence decision making of the audit function.</p>	<p>Not considered in the IFAC Code of Ethics.</p>	<p>The IFAC Code of Ethics does not cover the issue of the provision of services to owners of the audit firm. The EC Recommendation is unclear: who is an owner?</p>

**Appendix 2 – Chapter 2: Business Relationships – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>Business relationships involve having a commercial or financial interest in common and include, inter alia:</p> <ul style="list-style-type: none"> <li>• Financial interests in joint ventures.</li> <li>• Financial interests in entities with an investor/investee relationship with the client.</li> <li>• Loans or guarantees, to or from the client.</li> <li>• Providing services to senior management of the client in respect of personal interests.</li> <li>• Receiving services from the client in respect of securities issued by the audit firm or its group.</li> </ul>	<p>Close business relationships involve having a commercial or common financial interest and include, inter alia:</p> <ul style="list-style-type: none"> <li>• Material financial interests in joint ventures.</li> <li>• Commercial arrangements involving joint packaging of goods or services, or distribution or marketing arrangements.</li> </ul> <p>Loans or guarantees, to or from the client, are dealt with separately. Loans or deposits to/from the client are only acceptable if immaterial or in normal course of business and on normal commercial terms.</p>	<p>In substance, the concept of business relationships is similar between the two documents, though they do quote slightly different examples.</p> <p>Notwithstanding that loans are dealt with in different sections (the IFAC Code of Ethics covers them under financial interests) the effective difference is the same as that between the business relationship prohibitions: an immaterial amount, outside the normal course of business, would appear to be exempt from the prohibition in the IFAC Code of Ethics but not from that in the EC Recommendation.</p> <p>Only the EC Recommendation covers services to senior management and receiving services from the client in respect of securities issued by the audit firm. Not considered significant as any such circumstance would be covered by the framework approach.</p>
<p>Services, which fall within the normal course of business, should still be considered for potential threats if they are of a great magnitude.</p>	<p>Services, which fall within the normal course of business, should still be considered for potential threats if they are of a great magnitude.</p>	<p>The consideration of the threats posed by transactions in the normal course of business is similar in substance.</p>
<p>Accepting goods or services from the client on favourable terms is not acceptable unless the value of the benefit is insignificant.</p>	<p>A separate section (8.210) provides that accepting goods or services from the client on favourable terms is not acceptable unless the value of the benefit is clearly insignificant.</p>	<p>The codes provide similar guidance, albeit in different places, on accepting goods or services from clients on beneficial terms.</p>

<b>Appendix 2 – Chapter 3: Employment with the Audit Client – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>Employment with the audit client threatens independence in the following circumstances:</p> <ul style="list-style-type: none"> <li>• Dual employment in the audit firm and in the audit client.</li> <li>• Loan staff assignments to an audit client or any of its affiliates.</li> <li>• An engagement team member leaving the audit firm to join the audit client.</li> <li>• Former member of the engagement team or an individual within the chain of command joining an audit client.</li> <li>• A key audit partner leaving the audit firm to join the audit client for a key management position.</li> </ul>	<p>Employment with assurance clients threatens independence in the following circumstances:</p> <ul style="list-style-type: none"> <li>• If a member of the assurance team, partner or former partner of the firm has joined the assurance client;</li> <li>• If a member of the assurance team participates in the assurance engagement while knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future.</li> </ul>	<p>In these areas of employment with the audit client, the respective codes are comparable with no significant differences.</p> <p>Dual employment regarding a partner or employee in audit firm serving as an officer or director on the board of assurance clients is addressed in Chapter 4 – Managerial or Supervisory Role in Audit Client – of the IFAC Code of Ethics.</p>
<p>Where a member of the engagement team is to leave the audit firm and join an audit client, policies and procedures of the audit firm should provide immediate notification to the audit firm, immediate removal of the individual from the engagement team and immediate review of the audit work performed by the individual in question.</p>	<p>The IFAC Code of Ethics also deals with situations when a member of the assurance team participates in the assurance engagement while knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future. This threat can be reduced to an acceptable level by the application of policies and procedures to require the individual to notify the firm when entering serious employment negotiations with the assurance client and removal of</p>	<p>The trigger point for persons considering joining the client seems to be different. The IFAC Code of Ethics suggests it is when someone is seriously considering employment with the assurance client, the EC Recommendation when that person “is to” leave the audit firm.</p>

**Appendix 2 – Chapter 3: Employment with the Audit Client – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

EC Recommendation	IFAC Code of Ethics	Comments on the differences
	<p>the individual from the assurance engagement.</p> <p>In addition, consideration should be given to performing an independent review of any significant judgments made by that individual while on the engagement.</p>	
<p>Where a former member of the engagement team or an individual within the chain of command has joined an audit client, policies and procedures of the audit firm should ensure that there remain no significant connections between itself and the individual. This include:</p> <ul style="list-style-type: none"> <li>• Regardless of whether the individual was previously involved in the audit engagement, that all capital balances and similar financial interests must be fully settled (including retirement benefits) unless these are made in accordance with pre-determined arrangements that cannot be influenced by any remaining connections between the individual and the audit firm;</li> <li>• That the individual does not participate or appear to participate further in the audit firm’s business or professional activities.</li> </ul>	<p>If the threat is considered other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level.</p> <p>In all cases, all of the following safeguards are necessary to reduce the threat to an acceptable level:</p> <ul style="list-style-type: none"> <li>• The individual concerned is not entitled to any benefits or payments from the firm unless these are made in accordance with fixed pre-determined arrangements. In addition, any amount owed to the individual should not be of such significance to threaten the firm’s independence; and</li> <li>• The individual does not continue to participate or appear to participate in the firm’s business or professional activities.</li> </ul>	<p>Where the person has resigned from the firm and has joined the audit client, guidance might be helpful in relation to what constitute pre-determined arrangements that cannot be influenced by any remaining connections, notably pensions and capital, and explaining that continuing profit related shares are not appropriate.</p> <p>The requirements of the respective codes are comparable with no material differences.</p>

**Appendix 2 – Chapter 4: Managerial or Supervisory Role in Audit Client –  
Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

EC Recommendation	IFAC Code of Ethics	Comments on the differences
<p>The facts and circumstances threatening the independence of any individual who is in a position to influence the outcome of an audit engagement are as follows:</p> <ul style="list-style-type: none"> <li>• An individual who is in a position to influence the outcome of the statutory audit being a member of any management body (e.g. board of directors) of an audit client.</li> <li>• An individual who is in a position to influence the outcome of the statutory audit being a member of any supervisory body (e.g. audit committee or supervisory board) of an audit client.</li> <li>• An individual who is in a position to influence the outcome of the statutory audit being a member of such a body in an entity which holds directly or indirectly more than 20 % of the voting rights in the client</li> <li>• An individual who is in a position to influence the outcome of the statutory audit being a member of such a body in an entity in which the client holds directly or indirectly more than 20 % of the voting rights.</li> </ul>	<p>The facts and circumstances threatening the independence of a partner or employee serving as an officer or director on the board of assurance clients are as follows:</p> <ul style="list-style-type: none"> <li>• For assurance engagements if a partner or employee of the firm serving as an officer or as a director on the board of an assurance client.</li> <li>• In the case of an audit engagement, a partner or employee of a network firm who were to serve as an officer or as a director on the board of an audit client.</li> </ul>	<p>The EC Recommendation addresses “... should not be a member of any management body (e.g. board of directors) or supervisory body (e.g. audit committee or supervisory board). The equivalent language in the IFAC Code of Ethics is “serving as an officer or director on the board of an assurance client”. These differences of terminology are not considered to be significant.</p> <p>The EC Recommendation considers the threat posed by the auditor being a member of an entity which holds 20 % of the voting rights in the client or vice versa. This kind of threat is not directly considered by the IFAC Code of Ethics.</p>
<p>The audit firm’s internal safeguarding system should provide for adequate measures to identify and evaluate where the following prohibitions apply:</p> <ul style="list-style-type: none"> <li>• An individual who is in a position to influence the outcome of the statutory audit should not be a member</li> </ul>	<p>The threats created would be so significant that no safeguard could reduce the threats to an acceptable level. Consequently, if such an individual were to accept such a position the only course of action is to refuse to perform, or to withdraw from the assurance engagement.</p>	<p>The EC Recommendation establishes two prohibitions. The class of persons caught includes anyone in the audit firm or network (broadly defined) who is in a position to influence the outcome of the statutory audit. It also requires safeguards to be implemented where former members of the engagement team take such a</p>

**Appendix 2 – Chapter 4: Managerial or Supervisory Role in Audit Client –  
Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>of any management body or supervisory body of an audit client.</p> <ul style="list-style-type: none"> <li>An individual who is in a position to influence the outcome of the statutory audit should not be a member of any management body of an entity that is not an audit client (non-client entity), but is either in a position to influence the audit client or to be influenced by the audit client.</li> </ul>		<p>role.</p> <p>The IFAC Code of Ethics applies the prohibition to all partners and employees of the firm and the network firm. By applying it to all such persons, rather than just those who may influence the outcome of the audit, it appears to be wider scope than the EC Recommendation.</p> <p>Both codes contain an unconditional prohibition against an individual being a member of the engagement team at the same time as being a member of any management body or supervisory body, or serving as an officer or director on the board of the client.</p>
<p>Where national law requires members of the audit profession to undertake supervisory roles in certain companies, safeguards must ensure that such professionals do not have any responsibility with regard to the engagement team.</p>	<p>No guidance provided.</p>	<p>The IFAC Code of Ethics does not deal with this issue.</p>
<p>No guidance provided.</p>	<p>The role as a company secretary is discussed in the IFAC Code of Ethics. When the practice is specifically permitted under local law, professional rules or practice, the duties and functions undertaken should be limited to those of a routine and formal administrative nature such as the preparation of minutes and</p>	<p>The EC Recommendation does not deal with this issue.</p>

**Appendix 2 – Chapter 4: Managerial or Supervisory Role in Audit Client –  
Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
	maintenance of statutory returns.	
When a former member of an engagement team joins the management or supervisory body of the audit client, a period of at least two years should have elapsed.	When evaluating the significance of the threats and the need for safeguards when a former member of the engagement team assumes a managerial or supervisory role in an audit client, the length of time that has passed since the individual was a member of the assurance team or firm is to be considered.	The EC Recommendation states the length of time that should elapse whereas the IFAC Code of Ethics does not.  In all other respects the codes are comparable with no significant differences.

**Appendix 2 – Chapter 5: Establishing Employment with Audit Firm –  
Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

EC Recommendation	IFAC Code of Ethics	Comments on the differences
<p>Facts and circumstances threatening independence include:</p> <ul style="list-style-type: none"> <li>• Director or manager joining the audit firm (engagement team).</li> <li>• Director or manager joining the audit firm (chain of command).</li> <li>• Employee of the audit client joining the audit firm (engagement team).</li> <li>• Employee of the audit client joining the audit firm (chain of command).</li> </ul>	<p>Facts and circumstances threatening independence include:</p> <ul style="list-style-type: none"> <li>• A member of the assurance team who, during the period covered by the assurance report, had served as an officer or director of the assurance client.</li> <li>• A member of the assurance team who, during the period covered by the assurance report, had been an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement.</li> <li>• A member of the assurance team who, prior to the period covered by the assurance report, had served as an officer or director of the assurance client.</li> <li>• A member of the assurance team who, prior to the period covered by the assurance report, had been an employee in a position to exert direct and significant influence over the subject matter of the assurance.</li> </ul>	<p>The IFAC Code of Ethics distinguishes between:</p> <ul style="list-style-type: none"> <li>• Service provided during the period covered by the assurance report and</li> <li>• Service provided prior to the period covered by the assurance report.</li> </ul> <p>The EC Recommendation does not make this distinction.</p> <p>The IFAC Code of Ethics refers to ‘Director or Officer’ whereas the EC Recommendation refers to ‘Director or manager’. There is no significant difference.</p> <p>In the IFAC Code of ethics ‘the audit client’ will include affiliates where the audit client is a listed company, which is not the case in the EC Recommendation.</p>
<p>Safeguards:</p> <ul style="list-style-type: none"> <li>• Director or manager joining the engagement team: Prohibition for a two-year period after leaving the client against being a member of the engagement team and taking part in any substantive decisions concerning the client’s audit.</li> <li>• Director or manager joining the chain of command: Prohibition for a two-year period after leaving the client against taking part in any substantive decisions</li> </ul>	<p>Safeguards - Service provided during the period covered by the assurance report:</p> <p>Being a member of the assurance team is prohibited and consequently such individuals should not be assigned to the assurance team.</p> <p>Safeguards - Service provided prior to the period covered by the assurance report:</p>	<p>The EC Recommendation imposes a prohibition on joining the audit firm within two years after leaving the audit client”. In the IFAC Code of Ethics, the equivalent is the period covered by the assurance report.</p> <p>For IFAC Code of Ethics, the chain of command is included within the definition of assurance team and is not as broadly defined.</p>

**Appendix 2 – Chapter 5: Establishing Employment with Audit Firm –  
Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>concerning an audit engagement with this client or with one of its affiliates.</p> <ul style="list-style-type: none"> <li>Former employee of the audit client joining the chain of command in the audit firm: Prohibition for a two - year period after leaving the client against taking part in any substantive decisions concerning an audit engagement with this client or with one of its affiliates unless responsibilities held and tasks performed at the audit client were insignificant in relation to the statutory audit.</li> </ul>	<p>Before applying safeguards, the significance of the threat should be considered and evaluated. Significance depends upon factors such as:</p> <ul style="list-style-type: none"> <li>Position held with the assurance client</li> <li>Length of time passed since the individual left the assurance client</li> <li>The individual’s role on the assurance team</li> </ul> <p>If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>Involving an additional professional accountant to review the work performed by the individual as part of the assurance team or otherwise advise as necessary; or</li> <li>Discussing the issue with those charged with governance, such as the audit committee</li> </ul>	<p>The EC Recommendation impacts also former employees of the audit client. The IFAC Code of Ethics is less restrictive. This is because it defines the employee as having been “in a position to assert direct and significant influence over the subject matter of the assurance engagement.</p>

**Appendix 2 – Chapter 6: Family and other Personal Relationships – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>The EC Recommendation considers the threats posed by family and other personal relationships. It focuses on the ability of such individual to exert significant influence on the audit. The EC Recommendation identifies the relationships that pose a threat and suggests safeguards to mitigate such threats.</p> <p>Insofar as family relationships are concerned, the EC Recommendation focuses on the threats posed by close family members. Nevertheless, the EC Recommendation recognises the threats that may be posed by close non-family relationships.</p>	<p>The IFAC Code of Ethics similarly seeks to identify those relationships that pose a threat and suggests safeguards to mitigate them.</p> <p>The IFAC Code of Ethics introduces “two tiers” of family, close family and immediate family, and focuses on the treats posed by such relationships. The IFAC Code of Ethics too, recognises the threats posed by non-family relationships.</p>	<p>The threats, safeguards and persons covered by the EC Recommendation and the IFAC Code of Ethics insofar as statutory audits are concerned are comparable with no significant differences.</p> <p>The use in the IFAC Code of Ethics of “two tiers” of “family” results in a slightly different emphasis on the threat posed by certain family members. To comply with both codes, it is advisable to extend the basic requirements which apply to immediate family members to close family members. However, both the EC Recommendation and the IFAC Code of Ethics require the auditor to pay due regard to other “non-family” relationships (“close non-family” under the EC Recommendation and “person who is other than an immediate or close family member” under the IFAC Code of Ethics) in assessing the threats posed by such relationships. This assessment will depend on the auditor’s knowledge of the circumstances in relation to the audit client.</p>
<p>The EC Recommendation caters for inadvertent violations. It suggests safeguards that may be implemented to mitigate the threats posed as a result of inadvertent violations.</p>	<p>The IFAC Code of Ethics also recognises inadvertent violations. It similarly suggests possible safeguards to counter the threats as a consequence of such violations.</p>	<p>The circumstances and safeguards regarding inadvertent violations outlined by both the EC Recommendation and the IFAC Code of Ethics are comparable with no material differences.</p>

**Appendix 2 – Chapter 7: Non-Audit Services – The Comparison Overview: Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>The EC Recommendation addresses statutory auditors, audit firms and network member firms to provide services other than statutory audit work.</p>	<p>The IFAC Code of Ethics addresses firms and network firms.</p>	<p>The scope of the IFAC Code of Ethics is broader compared to the EC Recommendation. The IFAC Code of Ethics addresses a broad range of non-assurance services whereas the EC Recommendation only covers the provision of non-audit services to the same client. The IFAC Code of Ethics includes several examples for a restriction of the application to audit clients, for example provision of taxation services, provision of internal audit services, provision of IT Systems Services, temporary staff assignments, provision of litigation support services or provision of legal services.</p>
<p>The self-review threat is always considered too high to allow the provision of any services other than audit work.</p>	<p>The IFAC Code of Ethics promotes arguments in favour of providing non-audit services such as increasing the auditors’ understanding of the business. Decision-making for the client gives rise to self-interest or self-review threats.</p>	<p>Both documents include the concept of threats to independence and safeguards to reduce the risk to an acceptable level. The IFAC Code of Ethics discusses the advantages of the provision of non-assurance services to assurance clients. There is no such discussion in the EC Recommendation. The EC Recommendation prohibits decision-making, whereas the IFAC Code of Ethics addresses the issue only as a threat (that might be mitigated).</p>
<p>Specific safeguards that may mitigate a remaining independence threat:</p> <ul style="list-style-type: none"> <li>• Compartmentalising responsibilities in specific non-</li> </ul>	<p>Safeguards are similarly addressed under paragraphs 160 and 161 of section 8 of the IFAC Code of Ethics.</p>	<p>The codes are comparable with no significant differences.</p>

<b>Appendix 2 – Chapter 7: Non-Audit Services – The Comparison Overview: Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
audit engagements <ul style="list-style-type: none"> <li>• Routine notification</li> <li>• Secondary reviews</li> <li>• External review by another statutory auditor.</li> </ul>	Similar safeguards are noted.	The extensive examples under IFAC Code of Ethics might be used as guidance for the application of the EC Recommendation.
Any advice or assistance generally does not prevent the statutory auditor carrying out the work subject to certain safeguards.	Examples of activities, that may create self-review or self-interest threats: <ul style="list-style-type: none"> <li>• Having custody of an assurance client’s assets</li> <li>• Supervising assurance client employees in the performance of their normal recurring activities; and</li> <li>• Preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction (for example, purchase orders, payroll time records, and customer orders).</li> </ul>	The examples noted in the IFAC Code of Ethics seem to be permitted by the more general commentary in the EC Recommendation.
<b>Preparing Accounting Records and Financial Statements:</b>	<b>Preparing Accounting Records and Financial Statements:</b>	
The statutory auditor should not be involved in the decision-making process in respect of the entries or assumptions.	Management Decisions: The statutory auditor should not make management decisions when preparing accounting records and financial statements.	No difference
Audit clients that are not public interest entities: Only assistance that is solely of a technical or mechanical nature or the advice given is only of an informative nature does not impair independence.	Audit clients that are not Listed Entities: Reference to services of a routine or mechanical nature Examples of services, that would not necessarily compromise independence are nearly the same as in the EC Recommendation	No difference

<b>Appendix 2 – Chapter 7: Non-Audit Services – The Comparison Overview: Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>Public Interest Entity: Any assistance not within the statutory audit mandate would be perceived to cause an unacceptable high level of independence risk, and should therefore be prohibited.</p> <p>The statutory auditor’s assistance should be limited to carrying out technical or mechanical tasks and to providing advisory information on alternative standards and methodologies, which the audit client might wish to apply. EXCEPTION: Emergency situation</p>	<p>Audit Clients that are Listed Entities: No safeguard other than the prohibition of such services would reduce the threat created to an acceptable level.</p> <p>EXCEPTION: Emergency situation</p>	No difference
<p>Statutory audits on consolidated financial statements of public interest entities: Subject to certain conditions it is possible, that a local auditor will have to participate in the preparation of financial statements that are to be included in the audit client’s consolidated financial statements.</p>	<p>The provision of accounting and bookkeeping services of a routine or mechanical nature to divisions or subsidiaries of listed audit clients would not be seen as impairing independence provided that certain conditions are met.</p>	No material difference
<b>Design and Implementation of Financial Information Technology Systems (FITS):</b>	<b>Provision of IT Systems Services to Audit Clients:</b>	
<p>The significance of the self-review threat is considered too high, unless certain criteria are met. The provision of FITS that constitute a “turn key” project requires a written acknowledgement that the audit client’s management takes specified responsibilities.</p>	<p>The self-review threat is likely to be too significant unless appropriate safeguards are put in place.</p>	<p>The basic framework approach is the same. However, the EC Recommendation provides more restrictive criteria for example on the following issues:</p> <ul style="list-style-type: none"> <li>- “Turn key” project</li> <li>- Large company or Public Interest Entity</li> </ul>

<b>Appendix 2 – Chapter 7: Non-Audit Services – The Comparison Overview: Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>The independence risk for systems design and implementation must carefully be assessed if there are public interest implications. In the case of a design project for a large company or public interest entity the independence risk may however be perceived to be unacceptable (EC Recommendation’s spectrum of involvement).</p> <p>The independence of the statutory auditor will be compromised, if he has a significant financial interest or a significant business relationship with any of the systems suppliers.</p>		- Significant financial interest or significant business relationship
<p>In cases not prohibited additional safeguards are needed to mitigate the remaining self-review threat (i.e. services that involve the design and implementation of financial information technology systems should only be provided by an expert team with different personnel and different reporting lines to those of the audit engagement team).</p>	<p>Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the audit engagement and with different reporting lines within the firm.</p>	No difference
<b>Valuation Services:</b>	<b>Valuation Services:</b>	
<p>The significance of the self-review threat is considered too high to allow the provision of valuation services, which lead to the valuation of amounts that are ‘material’ in relation to the financial statements and where the valuation involves a significant degree of ‘subjectivity’ inherent in the item concerned.</p>	<p>If the valuation service involves the valuation of matters ‘material’ to the financial statements and the valuation involves a significant degree of ‘subjectivity’, the self-review threat created could not be reduced to an acceptable level by the application of any safeguard. Accordingly, such valuation services should not be provided.</p>	No difference

<b>Appendix 2 – Chapter 7: Non-Audit Services – The Comparison Overview: Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
Valuation services: A valuation comprises the making of assumptions. Typical “due diligence” work in connection with the sale or purchase of a business is not regarded as a valuation service under this principle.	Valuation services A valuation comprises the making of assumptions with regard to future developments, the application of certain methodologies and techniques, and the combination of both in order to compute a certain value, or range of values.	The IFAC Code of Ethics does not cover this situation.
Materiality and Subjectivity	Materiality and Subjectivity	In substance no difference.
Some valuation services involve an ‘insignificant’ ‘degree’ of ‘subjectivity’. In these cases a remaining self-review threat should be mitigated by additional safeguards. It may be appropriate to set up a valuation service team separate from the engagement team, with different reporting lines for both.	Guidance for additional safeguards like involving an additional professional accountant or confirming with the audit client’s understanding of the underlying assumptions.	Additional safeguards and the possibility to mitigate the remaining self-review threat for an insignificant degree of subjectivity are addressed.
Not explicitly addressed.	Services subject to external review, for example services for the purpose of making a filing, a return to a tax authority or for tax planning would not create a significant threat to independence.	Not explicitly addressed in the EC Recommendation.
<b>Participation in the audit client’s internal audit:</b>	<b>Provision of internal audit services to audit clients:</b>	
To mitigate the self-review threats, the statutory auditor should: <ul style="list-style-type: none"> <li>• Satisfy himself that the audit client’s management or governance body is at all times responsible for the</li> </ul>	Appropriate safeguards should be put in place and the firm, or network firm, should, in particular, ensure that the audit client acknowledges its responsibilities for establishing, maintaining and monitoring the system of	The criteria in both codes are the same. However, the language in the EC Recommendation is stricter.

<b>Appendix 2 – Chapter 7: Non-Audit Services – The Comparison Overview: Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>overall system of internal control, determining the scope, risk and frequency of the internal audit procedures to be performed and considering and acting on the findings and recommendations provided by the internal audit or during the course of a statutory audit and</p> <ul style="list-style-type: none"> <li>• Not accept the outcomes of internal auditing processes for statutory audit purposes without adequate review.</li> </ul>	<p>internal controls.</p>	
<b>Acting for the audit client in the resolution of litigation:</b>	<b>Provision of litigation support services to audit clients:</b>	
<p>A self-review threat may arise if such a service includes the estimation of the audit client’s chances in the resolution of litigation, and thereby affects the amounts to be reflected in the financial statements.</p>	<p>More restrictive wording, only referring to “receivables” or “payables” instead of referring to financial statements.</p>	<p>In substance no difference.</p>
<p>The advocacy and the self-review threat is considered too high if the matter would reasonably be expected to have a ‘material impact’ on the clients financial statements and a ‘significant degree of subjectivity’ inherent in the case concerned. If both criteria apply, acting for the audit client in the resolution of litigation is prohibited.</p>	<p>Similar criteria are applied: ‘Materiality’ and ‘Degree of subjectivity’. However “if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.</p>	<p>If both criteria apply, the EC Recommendation prohibits the services, whereas the IFAC Code of Ethics allows it subject to safeguards being applied.</p>
<b>Recruiting Senior Management:</b>	<b>Recruiting Senior Management:</b>	
<p>The provision of a list of potential candidates for key financial and administration posts may cause an</p>	<p>The IFAC Code of Ethics generally allows a firm to provide services as reviewing the professional</p>	<p>The EC Recommendation applies more restrictive criteria.</p>

**Appendix 2 – Chapter 7: Non-Audit Services – The Comparison Overview: Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<p>unacceptable level of independence risk.                      Insofar as statutory audits of public interest entities are concerned, the independence risk would be perceived too high to allow the provision of such a list.</p>	<p>qualification of a number of applicants and provides advice on their suitability for the post. In addition, it allows the firm to produce a short list of candidates for interview, provided it has been drawn up using criteria specified by the assurance client.</p>	

**Appendix 2 – Chapter 8: Audit and Non-Audit Fees – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

EC Recommendation	IFAC Code of Ethics	Comments on the differences
<p><b>Contingent Fees</b></p> <p>Audit engagements should never be accepted on a contingent fee basis and the basis for the calculation of the audit fees must be agreed each year in advance.</p> <p>Contingent fee arrangements for non-audit services are never concluded without first assessing the independence risk it might create and ensuring that appropriate safeguards are available to reduce this risk to an acceptable level.</p>	<p><b>Contingent Fees</b></p> <p>A firm should not enter into any contingent fee arrangement for an assurance engagement.</p> <p>A contingent fee charged by a firm in respect of a non-assurance service provided to an assurance client may also create threats. If the threats could not be reduced to an acceptable level by the application of any safeguard. The only acceptable action is not to accept such arrangement.</p>	<p>There are no material differences between the IFAC Code of Ethics and the EC Recommendation.</p> <p>The EC Recommendation provides, in particular, for a safeguarding system in case of contingent fee arrangements for non-audit services provided to an audit client:</p> <ul style="list-style-type: none"> <li>• Such an arrangement is never concluded without first assessing the independence risk that it might create;</li> <li>• The non-audit engagement must be refused or the auditor must resign from the statutory audit unless the statutory auditor is satisfied that there are appropriate safeguards in place to overcome the independence threats.</li> </ul> <p>The IFAC Code of Ethics specifically prohibits fees in respect of a non-assurance engagement provided to an assurance client and contingent on the result of the assurance engagement. For other types of contingent fee arrangements, safeguards that may be implemented to reduce the threats to an acceptable level might include disclosing to the audit committee the extent of nature and extent of fees charged, and the review of the final fee by an unrelated third party. The EC Recommendation does not make such a distinction between different types of contingent fee arrangements for non-audit services.</p>

<b>Appendix 2 – Chapter 8: Audit and Non-Audit Fees – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<b>Relationship between total fees and total revenue</b>	<b>Fees – Relative Size</b>	
<p>The provision of any (audit and non-audit) services should not create a financial dependency. This is considered to exist when the total (audit and non-audit) fees that an audit firm, or a network receives or will receive from one audit client and its affiliates make up an unduly high percentage of the total revenues in each year over a five-year period.</p> <p>The statutory auditor should also consider whether there are certain fee relationships which may appear to create a financial dependency in respect of a person who is in a position to influence the outcome of the statutory audit.</p>	<p>When the total fees generated by an assurance client represent a large proportion of a firm’s total fees, the dependence on that client group and concern about the possibility of losing the client may create a self-interest threat.</p> <p>Safeguards should be considered and applied to reduce the threat to an acceptable level.</p> <p>A self-interest threat may also be created when the fees generated by the assurance client represent a large proportion of the revenue of an individual partner.</p>	<p>The EC Recommendation provides that a financial dependency exists when the audit firm or a network receives from an audit client and its affiliates an unduly high percentage of the total revenues in each year over a five-year period. Although the IFAC Code of Ethics does not provide for such a clear definition of financial dependency, it states that a threat might be created by dependence on a client group and concern about the possibility of losing the client when the total fees generated by an assurance client represent a large proportion of a firm’s total fees.</p> <p>Whilst the EC Recommendation analyses the appearance of financial dependency as well as certain other fee relationships that may cause self-interest threats, the IFAC Code of Ethics provides a few safeguards to reduce the self-interest threat to an acceptable level.</p>
<b>Overdue Fees</b>	<b>Fees – Overdue</b>	
<p>Where fees for audit or other work become significantly overdue and the sum outstanding, or that sum together with fees for current assignments could be regarded as a significant loan, the self-interest threat to independence is considered to be so significant that a statutory auditor should not accept reappointment or, where appropriate and practicable, should resign from the current audit engagement.</p>	<p>A self-interest threat may be created if fees due from an assurance client for professional services remain unpaid for a long time, especially if a significant part is not paid before the issuance of the assurance report for the following year.</p>	<p>No material differences, other than that only the IFAC Code of Ethics suggests, as a safeguard, discussing the level of outstanding fees with the audit committee, or others charged with governance.</p>

<b>Appendix 2 – Chapter 8: Audit and Non-Audit Fees – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
<b>Pricing</b>	<b>Pricing</b>	
A statutory auditor must be able to demonstrate that the fee for an audit engagement is adequate to cover the assignment of appropriate time and qualified staff to the task and compliance with all auditing standards, guidelines and quality control procedures.	When a firm obtains an assurance engagement at a significantly lower fee level than that charged by the predecessor firm, or quoted by other firms, the self-interest threat created will not be reduced to an acceptable level unless the firm is able to demonstrate that appropriate time and qualified staff are assigned to the tasks and all applicable assurance standards, guidelines and quality control procedures are being complied with.	No material differences, other than that the EC Recommendation provides that the statutory auditor must be able to demonstrate that a quoted audit fee is not dependent on the expected provision of non-audit services. In addition, the EC Recommendation provides that where statutory audits of public interest entities are concerned, the statutory auditor should discuss the basis for calculating the audit fee with the governance body. Such issues are not addressed by the IFAC Code of Ethics.

<b>Appendix 2 – Chapter 9: Litigation – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
Parties to the dispute: Statutory auditor, audit firm or any other person being in a position to influence the outcome of the statutory audit and Audit client or its affiliates.	Parties to the dispute: Firm or a member of the assurance team and Assurance client or client management.	No material differences (allowing for general scope issues re audit and assurance).
Threats: Self-interest threat and Advocacy threat	Threats: Self-interest threat or Intimidation threat	No difference.  Advocacy threat vs. intimidation threat
All of the audit and non-audit services provided to the client have to be considered in order to assess the threats.	The nature of the assurance engagement determines the significance of the threat.	No material differences.
Important factors : • Serious likelihood of litigation which is material to any of the parties involved • Relation to prior statutory audit	Important factors: • The materiality of litigation • Relation to prior assurance engagement	No material differences.
Safeguard: • Discussion with the governance body	Safeguard: • Disclosure to the audit committee	No material differences.

<b>Appendix 2 – Chapter 9: Litigation – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
	Additional safeguards: <ul style="list-style-type: none"> <li>• Removing a person involved in the litigation from the assurance team</li> <li>• Involving an additional professional accountant</li> </ul>	Additional safeguards mentioned in the IFAC Code of Ethics only.
If the discussion with the governance body confirms the judgement that it is probable that a claim will be filed, then the statutory auditor should resign.	If the safeguards do not reduce the threat to an appropriate level, the only appropriate action is to withdraw from, or refuse to accept, the assurance engagement.	No material differences.

**Appendix 2 – Chapter 10: Senior Personnel acting for a long period of time – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences**

EC Recommendation	IFAC Code of Ethics	Comments on the differences
<p>Familiarity threats may arise where members of the engagement team act for long period of time, particularly where public interest entity audit clients are concerned.</p>	<p>The IFAC Code of Ethics addresses the same threats, but also lists factors that the significance of the threats will depend on:</p> <ul style="list-style-type: none"> <li>• Length of time</li> <li>• Role of the team member</li> <li>• Structure of the firm</li> <li>• Nature of the engagement</li> </ul> <p>The significance should be evaluated and safeguards should be considered and applied. Such safeguards might include:</p> <ul style="list-style-type: none"> <li>• Rotating the senior personnel off the assurance team</li> <li>• Involving an additional professional accountant to review the work done</li> <li>• Independent internal quality reviews.</li> </ul>	<p>The substance of the requirements in both codes is the same as they both deal with the familiarity threat of senior personnel acting for a long period of time on an audit engagement. The IFAC Code of Ethics, however lists the safeguards in the general paragraph.</p>
<p>To mitigate the threats, where public interest entity audit clients are concerned, the auditor is required to replace key audit partners within seven years. The replaced partner should not return to the audit team until a two- year period has elapsed. This safeguard cannot be replaced by other safeguards.</p>	<p>For audit clients that are listed entities, the lead audit partner should be rotated after a pre-defined period, normally no more than seven years</p> <p>The replaced partner should not resume the lead engagement partner role until normally two years have elapsed.</p>	<p>The EC Recommendation applies to “key audit partners” in relation to public interest entities whereas the IFAC Code of Ethics applies only to “the lead audit partner” of listed entities. The EC Recommendation therefore requires both a larger group of personnel to be replaced and applies to a larger group of entities.</p> <p>The number of years allowed to be served before rotation is the same for both codes.</p> <p>The period before a rotated team member can resume his responsibility is the same in both documents.</p>

<b>Appendix 2 – Chapter 10: Senior Personnel acting for a long period of time – Comparisons: Essence of the EC guidance compared with the equivalent IFAC guidance and comments on differences</b>		
<b>EC Recommendation</b>	<b>IFAC Code of Ethics</b>	<b>Comments on the differences</b>
		<p>The EC Recommendation states that the requirement to replace the engagement partner and other key audit partners cannot be replaced by other safeguards in relation to audits of public interest entities.</p> <p>The IFAC Code of Ethics provides several examples where rotation of lead audit partner may be difficult and where some degree of flexibility over timing of rotation may be necessary. In such cases, it nevertheless requires safeguards to be applied to reduce any threats to an acceptable level.</p>
<p>Insofar as public interest entity audit clients are concerned, to mitigate the threats to independence, the auditor is required to consider the risk of long association of other team members (than the key audit partners) and adopt safeguards to reduce the risk to an acceptable level</p>	<p>No guidance provided.</p>	<p>The IFAC Code of Ethics does not discuss the rotation of other audit team members (it is restricted to rotation of the lead audit partner) (except for a general discussion).</p>
<p>For non public interest entity audit clients, the same safeguards as suggested for public interest entity audit clients should be applied. However, where the audit firm is unable to rotate key audit partners, the statutory auditor should determine what other safeguards should be adopted to reduce the independence risk to an acceptable level.</p>	<p>No guidance provided.</p>	<p>The IFAC Code of Ethics does not discuss in detail the rotation of key audit team members for non-listed entities.</p> <p>However, many of the safeguards mentioned for key audit partners dealing with audits of public interest entities and for audit team members of non public interest companies are listed as possible safeguards for listed companies in the IFAC Code of Ethics.</p>