

Structure of the Code—Post-Consultation Paper Draft Restructured Code

PART A FUNDAMENTAL PRINCIPLES AND CONCEPTUAL FRAMEWORK

Section 100

Compliance with the Code, Fundamental Principles and Conceptual Framework

Terms Used

- 100.1 In Part A, “professional accountant” refers to:
- (a) Professional accountants in business; and
 - (b) Professional accountants in public practice and the firms within which they practice.

Scope of this Part

- 100.2 This Part establishes requirements and provides guidance for professional accountants regarding matters that are fundamental to acting in the public interest, namely:
- (a) The fundamental principles;
 - (b) The conceptual framework approach which includes addressing threats to those fundamental principles and implementing safeguards; and
 - (c) The approach to ethical conflict resolution;

Requirements and Related Application Material

- R100.3** A professional accountant shall comply with this Code. There may be circumstances when a professional accountant is prohibited from complying with certain parts of this Code by law or regulation. In that event, the professional accountant shall comply with all other parts of this Code.
- 100.3 A1 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a professional accountant’s responsibility is not exclusively to satisfy the needs of an individual client or employer.
- 100.3 A2 When a professional accountant encounters unusual circumstances in which the application of a specific requirement of the Code would result in a disproportionate outcome or an outcome that may not be in the public interest, it is recommended that the professional accountant consult with a member body or the relevant regulator.
- R100.4** When a professional accountant identifies a breach of a provision of this Code, the professional accountant shall:
- (a) Evaluate the significance of the breach;
 - (b) Evaluate the impact of the breach on the professional accountant’s ability to comply with the fundamental principles;
 - (c) Take whatever actions may be available, as soon as possible, satisfactorily to address the consequences of the breach;

- (d) Determine whether to report the breach, for example, to those who may have been affected by the breach, a professional regulatory body, another relevant regulator or oversight authority, or others; and
- (e) Comply with the provisions of Parts C2 and C3 that establish the requirements for professional accountants to address breaches of the provisions set out in those Parts.

Section 110

Fundamental Principles

Requirements and Related Application Material

R110.1 A professional accountant shall comply with the following fundamental principles:

- (a) Integrity – to be straightforward and honest in all professional and business relationships.
- (b) Objectivity – to provide professional or business judgments without bias, conflict of interest or undue influence of others.
- (c) Professional Competence and Due Care – to:
 - (i) Maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service, based on current developments in practice, legislation and techniques; and
 - (ii) Act diligently and in accordance with applicable technical and professional standards.
- (d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not to:
 - (i) Disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose; or
 - (ii) Use the information for the personal advantage of the professional accountant or third parties.
- (e) Professional Behavior – to comply with relevant laws and regulations and avoid any action that discredits the profession.

110.1 A1 Acting in the public interest requires professional accountants to uphold five fundamental principles: Integrity; Objectivity; Professional Competence and Due Care; Confidentiality; and Professional Behavior.

Integrity

R110.2 A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

- (a) Contains a materially false or misleading statement;
- (b) Contains statements or information provided recklessly; or
- (c) Omits or obscures required information where such omission or obscurity would be

misleading.

110.2 A1 The fundamental principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness.

R110.3 When a professional accountant becomes aware that the professional accountant has been associated with information described in R110.2, the professional accountant shall take steps to be disassociated from that information, unless providing a modified report in respect of such information.

Objectivity

R110.4 When undertaking any professional activity, a professional accountant:

- (a) Shall determine whether there are threats to compliance with the fundamental principle of objectivity resulting from having interests in, or relationships with, a client or its directors, officers or employees; and
- (b) Shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

110.4 A1 The fundamental principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or undue influence of others. The existence of threats to objectivity when undertaking any professional activity will depend upon the particular circumstances of the engagement and the nature of the work that the professional accountant is performing.

110.4 A2 Examples of safeguards that may be available to address threats to objectivity include:

- Supervisory procedures;
- Discussing the issue:
 - With higher levels of management within the firm; or
 - With those charged with governance of the client;
- Withdrawing from the engagement team; or
- Ending the financial or business relationship giving rise to the threat.

110.4 A3 A professional accountant in public practice who provides an assurance service is required to be independent of the assurance client. Independence of mind and in appearance is necessary to enable the professional accountant to express and be seen to express an objective conclusion. Such a conclusion is one without bias, conflict of interest or undue influence by others.

110.4 A4 Parts C2 and C3 provide specific guidance on independence requirements for professional accountants in public practice when performing assurance engagements.

Professional Competence and Due Care

- R110.5** A professional accountant shall:
- (a) Maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and
 - (b) Act diligently in accordance with applicable technical and professional standards when performing professional activities or providing professional services.
- 110.5 A1 Serving clients and employers with professional competence requires the exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities and providing professional services. Professional competence and due care may be divided into two separate phases:
- (a) Attainment of professional competence; and
 - (b) Maintenance of professional competence.
- 110.5 A2 The maintenance of professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. Continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment.
- 110.5 A3 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.
- R110.6** A professional accountant shall take reasonable steps to ensure that those working under the professional accountant's authority in a professional capacity have appropriate training and supervision.
- R110.7** Where appropriate, a professional accountant shall make clients, employers or other users of the accountant's professional services or activities aware of the limitations inherent in the services or activities.

Confidentiality

- R110.8** A professional accountant shall:
- (a) Maintain confidentiality and be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or a close or immediate family member;
 - (b) Maintain confidentiality of information within the firm or employing organization;
 - (c) Maintain confidentiality of information disclosed by a prospective client or employer;
 - (d) Not disclose outside the firm or employing organization confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose;
 - (e) Not use confidential information acquired as a result of professional and business relationships for personal advantage or for the advantage of third parties;

- (f) Not use or disclose any confidential information either acquired or received as a result of a professional or business relationship after such a relationship has been terminated; and
- (g) Take reasonable steps to ensure that staff under the professional accountant's control and persons from whom advice and assistance is obtained respect the professional accountant's duty of confidentiality.

110.8 A1 The need to comply with the principle of confidentiality continues even after the end of relationships between a professional accountant and a client or employer. When changing employment or acquiring a new client, the professional accountant is entitled to use prior experience but may not use or disclose any confidential information acquired or received as a result of a professional or business relationship.

110.8 A2 The following are circumstances where professional accountants are, or may be required to, disclose confidential information or when such disclosure may be appropriate:

- (a) Disclosure is permitted by law and is authorized by the client or the employer;
- (b) Disclosure is required by law, for example:
 - (i) Production of documents or other provision of evidence in the course of legal proceedings; or
 - (ii) Disclosure to the appropriate public authorities of infringements of the law that come to light; and
- (c) There is a professional duty or right to disclose, when not prohibited by law:
 - (i) To comply with the quality review of a member body or professional body;
 - (ii) To respond to an inquiry or investigation by a member body or regulatory body;
 - (iii) To protect the professional interests of a professional accountant in legal proceedings; or
 - (iv) To comply with technical standards and ethics requirements.

110.8 A3 In deciding whether to disclose confidential information, relevant factors to consider include:

- Whether the interests of all parties, including third parties whose interests may be affected, could be harmed if the client or employer consents to the disclosure of information by the professional accountant.
- Whether all the relevant information is known and substantiated, to the extent practicable. The type of disclosure to be made, if any, may be impacted by:
 - Unsubstantiated facts;
 - Incomplete information; or
 - Unsubstantiated conclusions.
- The type of communication that is expected and to whom it is addressed.
- Whether the parties to whom the communication is addressed are appropriate recipients.

Professional Behavior

- R110.9** A professional accountant shall comply with all relevant laws and regulations and avoid any action that the professional accountant knows or should know may discredit the profession.
- 110.9 A1 Actions that may discredit the profession include actions that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude adversely affects the good reputation of the profession.
- R110.10** When marketing or promoting themselves and their work, professional accountants shall not bring the profession into disrepute. Professional accountants shall be honest and truthful and shall not make:
- (a) Exaggerated claims for:
 - (i) The services they are able to offer;
 - (ii) The qualifications they possess; or
 - (iii) Experience they have gained.
 - (b) Disparaging references or unsubstantiated comparisons to the work of others.
- R110.11** If a professional accountant is in doubt about whether a proposed form of advertising or marketing is appropriate, the professional accountant shall consider consulting with the relevant professional body.

The safeguards project scope includes extant Code paragraphs 100.12 – 100.16 which are equivalent to Post CP draft restructured Code paragraphs 120.1 A3 – A8.

These paragraphs will only be presented to the IESBA for review once the Safeguards Task Force has completed its work. They have been shaded in grey where they occur in this text to indicate that they have been included for reference only and not for review.

Section 120

Conceptual Framework

Requirements and Related Application Material

Applying the Conceptual Framework Approach – Threats and Safeguards

- R120.1** A professional accountant shall use professional judgment to apply the conceptual framework of this Code in order to comply with the fundamental principles and shall:
- (a) Identify threats to compliance with the fundamental principles
 - (b) Evaluate the significance of the threats identified; and
 - (c) Either:
 - (i) Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level: or,
 - (ii) When the professional accountant determines that appropriate safeguards are not available or cannot be applied to eliminate the threats or reduce them to an acceptable level, eliminate the circumstance or relationship creating the threat or decline or terminate the engagement.
- R120.2** In complying with the provisions set out in paragraphs R110.1 and R120.1, a professional accountant shall:
- (a) Evaluate any threats to compliance with the fundamental principles when the professional accountant knows, or could reasonably be expected to know, of circumstances or relationships that may compromise compliance with them;
 - (b) Take into account whether a reasonable and informed third party, weighing all the facts and circumstances available to the professional accountant at the time, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of the safeguards, such that compliance with the fundamental principles is not compromised; and
 - (c) Take qualitative as well as quantitative factors into account when evaluating the significance of a threat.
- 120.2 A1** The circumstances in which professional accountants operate may create specific threats to compliance with the fundamental principles. It is impossible to define every situation that creates threats to compliance with the fundamental principles and to specify the appropriate action. In addition, the nature of engagements and work assignments may differ and, consequently, different threats may be created, requiring the application of different

safeguards. Therefore, this Code establishes a conceptual framework that requires professional accountants to identify, evaluate and address threats to compliance with the fundamental principles.

120.2 A2 The conceptual framework approach assists professional accountants in complying with the ethical requirements of this Code and meeting their responsibility to act in the public interest. It accommodates many variations in circumstances that create threats to compliance with the fundamental principles. It can deter professional accountants from concluding that a situation is permitted even if it is not specifically prohibited.

120.2 A3 Threats may be created by a broad range of relationships and circumstances. When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant's compliance with the fundamental principles. A circumstance or relationship may create more than one threat and a threat may affect compliance with more than one fundamental principle. Threats fall into one or more of the following categories:

- (a) Self-interest threat – that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior;
- (b) Self-review threat – that a professional accountant will not appropriately evaluate the results of a previous judgment made or activity or service performed by:
 - (i) The professional accountant; or
 - (ii) Another individual within the professional accountant's firm or employing organization,
on which the professional accountant will rely when forming a judgment as part of providing a current service;
- (c) Advocacy threat – that a professional accountant will promote a client's or employer's position to the point that the professional accountant's objectivity is compromised;
- (d) Familiarity threat – that due to a long or close relationship with clients or employers, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – that a professional accountant will be deterred from acting objectively because of actual or perceived pressures. This includes attempts to exercise undue influence over the professional accountant.

120.2 A4 When applying the conceptual framework, a professional accountant may encounter situations in which threats cannot be eliminated or reduced to an acceptable level. This may be either because the threat is too significant or because appropriate safeguards are not available or cannot be applied.

120.2 A5 Safeguards are actions or other measures that may eliminate threats or reduce them to an acceptable level. They fall into two broad categories:

- Safeguards created by the profession, legislation or regulation; and
- Safeguards in the work environment.

120.2 A6 Safeguards created by the profession, legislation or regulation include:

- Educational, training and experience requirements for entry into the profession.
- Continuing professional development requirements.
- Corporate governance.
- Professional standards.
- Professional or regulatory monitoring and disciplinary procedures.
- External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.

120.2 A7 Part B discusses safeguards in the work environment for professional accountants in business. Part C of this Code discusses safeguards in the work environment for professional accountants in public practice:

- Safeguards available to professional accountants in business may be in the form of systems and procedures that have been implemented by the organization that employs such professional accountants.
- Such systems and procedures may also be considered by a professional accountant in public practice in the evaluation of the significance of a specific threat to independence, as set out in Parts C2 and C3.
- Professional accountants in public practice also need to rely on the firm-wide safeguards or engagement-specific safeguards that are available to them in order to comply with the fundamental principles.

120.2 A8 Certain safeguards may increase the likelihood of identifying or deterring unethical behavior. Such safeguards, which may be created by the accounting profession, legislation, regulation or an employing organization, include:

- Effective complaint systems which enable colleagues, employers and members of the public to draw attention to unprofessional or unethical behavior operated by:
 - The employing organization;
 - The profession;
 - A regulator; or
- An explicitly stated duty to report breaches of ethical requirements.

Ethical Conflict Resolution

R120.3 When resolving a conflict in complying with the fundamental principles, the professional accountant shall:

- (a) Determine the appropriate course of action, weighing the consequences of each possible course of action;
- (b) If the matter involves a conflict with, or within, an organization, determine whether to consult with those charged with governance of the organization.

- (c) If, after exhausting all relevant possibilities the ethical conflict remains unresolved, refuse, where possible, to remain associated with the matter creating the conflict; and
 - (d) Determine whether in the circumstances it is appropriate to:
 - (i) Withdraw from the engagement team or specific assignment; or
 - (ii) Resign altogether from the engagement, the firm or the employing organization.
- 120.3 A1 A professional accountant may be required to resolve a conflict in complying with the fundamental principles.
- 120.3 A2 When initiating either a formal or informal conflict resolution process, the following factors, either individually or together with other factors, may be relevant to the resolution process:
- (a) Relevant facts.
 - (b) Ethical issues involved including the related fundamental principles.
 - (c) Established internal procedures.
 - (d) Alternative courses of action.
 - (e) Consultation with other appropriate persons within the firm or employing organization.
- 120.3 A3 It may be in the best interests of the professional accountant to document the substance of the issue, the details of any discussions held and the decisions made concerning that issue.
- 120.3 A4 If a significant conflict cannot be resolved, a professional accountant may consider obtaining professional advice from the relevant professional body or from legal advisors. The professional accountant can generally obtain guidance on ethical issues without breaching the fundamental principle of confidentiality if the matter is discussed:
- With the relevant professional body on an anonymous basis; or
 - With a legal advisor under the protection of legal privilege.
- 120.3 A5 Instances in which the professional accountant may consider obtaining legal advice vary. For example, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality. The professional accountant may consider obtaining legal advice in that instance to determine whether there is a requirement to report.

Those Charged with Governance

- R120.4** When communicating with those charged with governance in accordance with the provisions of this Code, the professional accountant shall determine the appropriate person(s) within the entity's governance structure with whom to communicate. If the professional accountant or firm communicates with a sub-group of those charged with governance, the professional accountant or firm shall determine whether communication with all of those charged with governance is also necessary.
- 120.4 A1 In determining the appropriate person(s) within the entity's governance structure with whom to communicate, the professional accountant may consider:
- The nature and importance of the particular circumstances; and

- The matter to be communicated.

120.4 A2 If a professional accountant communicates with a sub-group of those charged with governance, for example, an audit committee or an individual, communication with all of those charged with governance may also be necessary to ensure they are adequately informed.

The safeguards project scope includes extant Code paragraphs 200.3 – 200.15 which are equivalent to draft Restructured Code Section 300.

These paragraphs will only be presented to the IESBA for review once the Safeguards Task Force has completed its work. They have been highlighted in grey where they occur in this text to indicate that they have been included for reference only and not for review.

PART C PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

Part C1 Application of the Conceptual Framework for Professional Accountants in Public Practice

Section 300

Introduction

Terms Used

300.1 In Part C, the term “**professional accountant**” refers to professional accountants in public practice and the firms within which they practice.

Scope of this Part

300.2 This Part of the Code describes how the conceptual framework contained in Section 120.X applies in certain situations to professional accountants.

Core Requirement and Related Application Material

R300.3 A professional accountant shall comply with each of the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 in relation to threats to those fundamental principles.

300.3 A1 This Part does not describe all of the circumstances and relationships that could be encountered by professional accountants that create or may create threats to compliance with the fundamental principles. Therefore, professional accountants are encouraged to be alert for such circumstances and relationships.

Conceptual Framework – Threats and Safeguards

Threats

300.3 A2 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances and relationships. The nature and significance of the threats may differ depending on whether they arise in relation to:

- The provision of services to an audit client and whether such a client is a public interest entity;
- An assurance client that is not an audit client; or
- A non-assurance client.

300.3 A3 Threats fall into one or more of the following categories:

- Self-interest;
- Self-review;
- Advocacy;
- Familiarity; and
- Intimidation.

These threats are discussed further in Paragraphs 120.xxx to 120.xxx and 300.6 to 300.10 of this Code.

300.3 A4 Examples of circumstances that create self-interest threats for a professional accountant include:

- A member of the assurance team having a direct financial interest in the assurance client.
- A firm having undue dependence on total fees from a client.
- A member of the assurance team having a significant close business relationship with an assurance client.
- A firm being concerned about the possibility of losing a significant client.
- A member of the audit team entering into employment negotiations with the audit client.
- A firm entering into a contingent fee arrangement relating to an assurance engagement.
- A professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the professional accountant's firm.

300.3 A5 Examples of circumstances that create self-review threats for a professional accountant include:

- A firm issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.
- A firm having prepared the original data used to generate records that are the subject matter of the assurance engagement.
- A member of the assurance team being, or having recently been, a director or officer of the client.
- A member of the assurance team being, or having recently been, employed by the client in a position to exert significant influence over the subject matter of the engagement.
- The firm performing a service for an assurance client that directly affects the subject matter information of the assurance engagement.

300.3 A6 Examples of circumstances that create advocacy threats for a professional accountant include:

- The firm promoting shares in an audit client.
- A professional accountant acting as an advocate on behalf of an audit client in litigation or disputes with third parties.

300.3 A7 Examples of circumstances that create familiarity threats for a professional accountant include:

- A member of the engagement team having a close or immediate family member who is a director or officer of the client.
- A member of the engagement team having a close or immediate family member who is an employee of the client who is in a position to exert significant influence over the subject matter of the engagement.
- A director or officer of the client or an employee in a position to exert significant influence over the subject matter of the engagement having recently served as the engagement partner.
- A professional accountant accepting gifts or preferential treatment from a client, unless the value is trivial or inconsequential.
- Senior personnel having a long association with the assurance client.

300.3 A8 Examples of circumstances that create intimidation threats for a professional accountant include:

- A firm being threatened with dismissal from a client engagement.
- An audit client indicating that it will not award a planned non-assurance contract to the firm if it continues to disagree with the client's accounting treatment for a particular transaction.
- A firm being threatened with litigation by the client.
- A firm being pressured to reduce inappropriately the extent of work performed in order to reduce fees.
- A professional accountant feeling pressured to agree with the judgment of a client employee because the employee has more expertise on the matter in question.
- A professional accountant being informed by a partner of the firm that a planned promotion will not occur unless the professional accountant agrees with an audit client's inappropriate accounting treatment.

Evaluation of Threats

300.3 A9 The evaluation of threats may be affected by matters such as:

- The significance of the threat;
- The nature of the engagement; and
- The structure of the firm.

300.3 A10 Depending on the nature of the engagement, a professional accountant may also evaluate the impact of safeguards that the client has implemented on the significance of a threat. However, it is not possible to rely solely on the existence of such systems and procedures to conclude that a threat is not so significant as to require the application of safeguards to reduce it to an acceptable level.

300.3 A11 Examples of safeguards within the client that may impact the significance of a threat include:

- The client requires persons other than management to ratify or approve the appointment of a firm to perform an engagement.
- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that ensure objective choices in commissioning non-assurance engagements.
- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

Safeguards

300.3 A12 Safeguards that may eliminate or reduce threats to an acceptable level fall into two broad categories:

- (a) Those created by the profession, legislation or regulation; and
- (b) Those created in the work environment.

Examples of safeguards created by the profession, legislation or regulation are described in paragraph 120.X of this Code.

300.3 A13 In the work environment, the relevant safeguards will vary depending on the circumstances. Work environment safeguards comprise firm-wide safeguards and engagement-specific safeguards.

300.3 A14 Examples of firm-wide safeguards in the work environment include:

- Leadership of the firm that stresses the importance of compliance with the fundamental principles.
- Leadership of the firm that establishes the expectation that members of an assurance team will act in the public interest.
- Policies and procedures to implement and monitor quality control of engagements.
- Documented policies regarding the need to:
 - Identify threats to compliance with the fundamental principles;
 - Evaluate the significance of those threats; and
 - Apply safeguards to eliminate or reduce the threats to an acceptable level or, when appropriate safeguards are not available or cannot be applied, terminate or decline the relevant engagement.

- Documented internal policies and procedures requiring compliance with the fundamental principles.
- Policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients.
- Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client.
- Policies and procedures to prohibit individuals who are not members of an engagement team from inappropriately influencing the outcome of the engagement.
- Timely communication of a firm's policies and procedures, including any changes to them, to all partners and professional staff, and appropriate training and education on such policies and procedures.
- Designating a member of senior management to be responsible for overseeing the adequate functioning of the firm's quality control system.
- Advising partners and professional staff of assurance clients and related entities from which independence is required.
- A disciplinary mechanism to promote compliance with policies and procedures.
- Published policies and procedures to encourage and empower staff to communicate to senior levels within the firm any issue relating to compliance with the fundamental principles that concerns them.

300.3 A15 Examples of engagement-specific safeguards in the work environment include:

- Having a professional accountant who was not involved with the non-assurance service review the non-assurance work performed or otherwise advise as necessary.
- Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary.
- Consulting an independent third party, such as:
 - A committee of independent directors;
 - A professional regulatory body; or
 - Another professional accountant.
- Discussing ethical issues with those charged with governance of the client.
- Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
- Involving another firm to perform or re-perform part of the engagement.
- Rotating senior assurance team personnel.

Section 310

Conflicts of Interest

Scope

310.1 Conflicts of interest may cause threats to compliance with the fundamental principles. Section 310 sets out specific requirements and related application material in relation to applying the conceptual framework to conflicts of interest.

Core Requirement and Related Application Material

R310.2 If a conflict of interest arises a professional accountant shall apply the conceptual framework to:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the significance of the threats; and
- (c) Apply safeguards to eliminate or reduce the threat to an acceptable level.

If the threat caused by the conflict of interest cannot be eliminated or reduced to an acceptable level by the application of safeguards the professional accountant shall eliminate the circumstance creating the conflict of interest.

R310.3 When identifying and evaluating the interests and relationships that might create a conflict of interest and implementing safeguards, when necessary, to eliminate or reduce any threat to compliance with the fundamental principles to an acceptable level, a professional accountant in public practice shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that compliance with the fundamental principles is not compromised.

310.3 A1 Professional accountants may be faced with circumstances that give rise to a conflict of interest when performing professional services. A conflict of interest creates a threat to objectivity and may create threats to the other fundamental principles

310.3 A2 A conflict of interest may be created when:

- The professional accountant provides a professional service related to a particular matter for two or more clients whose interests with respect to that matter are in conflict; or
- The interests of the professional accountant with respect to a particular matter and the interests of the client for whom the professional accountant provides a professional service related to that matter are in conflict.

When a professional accountant provides an assurance service, compliance with the fundamental principle of objectivity also requires being independent of assurance clients in accordance with Part C2, as appropriate.

310.3 A3 Examples of situations in which conflicts of interest may arise include:

- Providing a transaction advisory service to a client seeking to acquire an audit client, where the firm has obtained confidential information during the course of the audit that

may be relevant to the transaction.

- Advising two clients at the same time who are competing to acquire the same company where the advice might be relevant to the parties' competitive positions.
- Providing services to both a vendor and a purchaser in relation to the same transaction.
- Preparing valuations of assets for two parties who are in an adversarial position with respect to the assets.
- Representing two clients regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership.
- Providing an assurance report for a licensor on royalties due under a license agreement when at the same time advising the licensee of the correctness of the amounts payable.
- Advising a client to invest in a business in which, for example, the spouse of the professional accountant has a financial interest.
- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a major competitor of the client.
- Advising a client on the acquisition of a business which the firm is also interested in acquiring.
- Advising a client on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service.

Evaluating the Threat and Applying Safeguards

310.3 A4 Factors that may be considered when evaluating a threat created by a conflict of interest include the significance of:

- Relevant interests or relationships; and
- The threats created by performing the professional service or services.

310.3 A5 In general, the more direct the connection between the professional service and the matter on which the parties' interests are in conflict, the more significant the threat to objectivity and compliance with the other fundamental principles will be.

310.3 A6 Examples of safeguards that may be available to address any such threat include:

- Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. This could include:
 - Using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality.
 - Creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential client information from one practice area to another within a firm.

- Establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners of the firm and/or the physical and electronic separation of confidential information.
- Regular review of the application of safeguards by a senior individual not involved with the client engagement or engagements.
- Having a professional accountant who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.
- Consulting with third parties, such as a professional body, legal counsel or another professional accountant.

Specific Requirements and Related Application Material

Judgment

R310.4 A professional accountant shall not allow a conflict of interest to compromise professional or business judgment.

Client Acceptance

R310.5 Before accepting a new client relationship, engagement, or business relationship, a professional accountant shall take reasonable steps to identify circumstances that might create a conflict of interest.

310.5 A1 The steps that a professional accountant may take to identify circumstances that might create a conflict of interest before accepting a new client relationship, engagement, or business relationship, include identification of the nature of the:

- Relevant interests and relationships between the parties involved; and
- Service and its implication for relevant parties.

310.5 A2 The nature of the services and the relevant interests and relationships may change during the course of the engagement. This is particularly true when a professional accountant is asked to conduct an engagement in a situation that may become adversarial, even though the parties who engage the professional accountant may not initially be involved in a dispute. This requires the professional accountant to remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

310.5 A3 Professional accountants are encouraged to have an effective conflict identification process in place. This may include matters identified by external parties, for example clients or potential clients. Such a process may assist a professional accountant in identifying interests and relationships that might create an actual or potential conflict of interest, prior to determining whether to accept an engagement. Such interests and relationships may also be identified by the process throughout an engagement. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of the professional accountant being able to apply safeguards, when necessary, to eliminate the threat to objectivity and compliance with the other fundamental principles or reduce it to an acceptable level. The process to identify actual or potential conflicts of interest will depend on such factors as the:

- Nature of the professional services provided.

- Size of the firm.
- Size and nature of the client base.
- Structure of the firm, for example, the number and geographic location of offices.

310.5 A4 Additional material regarding client acceptance is available in Section 320, *Professional Appointment*.

Changes in Circumstances

R310.6 A professional accountant shall remain alert to changes in the circumstances that might create a conflict of interest during the course of the engagement

Network Firms

R310.7 When the firm is a member of a network, a professional accountant shall consider any conflicts of interest that the professional accountant has reason to believe may exist or might arise due to interests and relationships of a network firm.

310.7 A1 The reasonable steps to be taken to identify interests and relationships involving a network firm that may create a conflict of interest will depend on factors such as the nature of the professional services provided, the clients served by the network and the geographic locations of all relevant parties.

Disclosure and Consent

R310.8 A professional accountant shall exercise professional judgment to determine whether the nature and significance of a conflict of interest is such that specific disclosure and explicit consent is necessary. In doing so, the professional accountant shall presume that such disclosure and consent is generally necessary.

310.8 A1 In most cases it is necessary to disclose the nature of the conflict of interest and the related safeguards, if any, to clients affected by the conflict and, when safeguards are required to reduce the threat to an acceptable level, to obtain their consent to the professional accountant performing the professional services. Disclosure and consent may take different forms, for example:

- General disclosure to clients of circumstances where the professional accountant, in keeping with common commercial practice, does not provide professional services exclusively for any one client (for example, in a particular professional service in a particular market sector) in order for the client to provide general consent. Such disclosure might, for example, be made in the professional accountant's standard terms and conditions for the engagement.
- Specific disclosure to affected clients of the circumstances of the particular conflict, including a detailed presentation of the situation and a comprehensive explanation of any planned safeguards and the risks involved, sufficient to enable the client to make an informed decision with respect to the matter and to provide explicit consent accordingly.
- In certain circumstances, consent may be implied by the client's conduct where the professional accountant has sufficient evidence to conclude that clients know the

circumstances at the outset and have accepted the conflict of interest if they do not raise an objection to the existence of the conflict.

- 310.8 A2 Determining whether the nature and significance of the conflict of interest is such that specific disclosure and explicit consent is necessary requires the professional accountant to exercise professional judgment in weighing the outcome of the evaluation of the circumstances that create a conflict of interest. Factors to consider include the parties that might be affected, the nature of the issues that might arise and the potential for the particular matter to develop in an unexpected manner.
- 310.8 A3 When disclosure is verbal, or consent is verbal or implied, the professional accountant is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the safeguards applied to reduce the threats to an acceptable level and the consent obtained.
- R310.9** When a professional accountant has requested explicit consent from a client and that consent has been refused by the client, the professional accountant shall either:
- (a) Decline to perform or discontinue professional services that would result in the conflict of interest; or terminate relevant relationships; or
 - (b) Dispose of relevant interests to eliminate the threat or reduce it to an acceptable level, so that consent can be obtained, after applying any additional safeguards if necessary.

Confidentiality

- R310.10** When addressing conflicts of interest, including making disclosures or sharing information within the firm or network and seeking guidance of third parties, a professional accountant shall remain alert to the fundamental principle of confidentiality.
- R310.11** When making specific disclosure for the purpose of obtaining explicit consent would result in a breach of confidentiality, the firm shall not accept or continue an engagement unless the following conditions are met:
- (a) The firm does not act in an advocacy role for one client where this requires the firm to assume an adversarial position against the other client with respect to the same matter;
 - (b) Specific mechanisms are in place to prevent disclosure of confidential information between the engagement teams serving the two clients;
 - (c) The firm is satisfied that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that it is appropriate for the firm to accept or continue the engagement because a restriction on the firm's ability to provide the professional service would produce a disproportionate adverse outcome for the clients or other relevant third parties; and
 - (d) The professional accountant documents:
 - (i) The nature of the circumstances, including the role that the professional accountant is to undertake;
 - (ii) The specific mechanisms in place to prevent disclosure of information between

the engagement teams serving the two clients; and

(iii) The rationale for the conclusion that it is appropriate to accept the engagement.

310.11 A1 Examples of circumstances in which making specific disclosure for the purpose of obtaining explicit consent would result in a breach of confidentiality may include:

- Performing a transaction-related service for a client in connection with a hostile takeover of another client of the firm.
- Performing a forensic investigation for a client in connection with a suspected fraudulent act where the firm has confidential information obtained through having performed a professional service for another client who might be involved in the fraud.

Section 320

Professional Appointment

Scope

320.1 Section 320 considers the threats to fundamental principles which may arise when accepting a new client or engagement or when changes in a professional appointment occur. Section 320 sets out specific requirement and application material in relation to applying the conceptual framework to professional appointments. Requirements and application material related to identifying circumstances that might create a conflict of interest regarding client acceptance are available in Section 310, *Conflicts of Interest*

Core Requirement and Related Application Material

R320.2 When considering whether to accept a new client or engagement or when changes in an existing professional appointment occur, the professional accountant shall apply the conceptual framework to:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the significance of the threats identified; and
- (c) Apply safeguards to eliminate or reduce the threat to an acceptable level.

If safeguards cannot be applied to eliminate or reduce threats to an acceptable level the professional accountant shall eliminate the circumstance creating the threat or decline or discontinue the engagement.

320.2 A1 Professional accountants may encounter circumstances in relation to changes in professional appointments, including accepting a new client or engagement that create threats to their compliance with each of the fundamental principles.

Client Acceptance and Continuance

320.2 A2 Acceptance of a new client relationship may create threats to compliance with the fundamental principles. Potential threats to integrity or professional behavior may be created from, for example, questionable issues associated with the client (its owners, management or activities).

320.2 A3 Client issues that, if known, could threaten compliance with the fundamental principles include, for example, client involvement in illegal activities (such as money laundering), dishonesty or questionable financial reporting practices.

320.2 A4 Examples of safeguards that may be available to address any such threat include:

- Obtaining knowledge and understanding of the client, its owners, managers and those charged with governance and business activities;
- Securing the client's commitment to improve corporate governance practices or internal controls; or
- Periodically reviewing acceptance decisions for recurring client engagements.

Engagement Acceptance

320.2 A5 A self-interest threat to professional competence and due care is created if the engagement team does not possess, or acquire, the relevant competencies to perform the professional services.

320.2 A6 Examples of safeguards that may be available to address any such threat include:

- Acquiring an appropriate understanding of:
 - The nature of the client's business;
 - The complexity of its operations;
 - The specific requirements of the engagement; and
 - The purpose, nature and scope of the work to be performed.
- Acquiring knowledge of relevant industries or subject matters.
- Possessing or obtaining experience with relevant regulatory or reporting requirements.
- Assigning sufficient staff with the necessary competencies.
- Agreeing on a realistic time frame for the performance of the engagement.
- Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.
- Using experts where necessary.

Specific Requirements and Related Application Material

Changes in Professional Appointment

R320.3 When a professional accountant is asked by a potential client to replace, consider tendering for an engagement held by, or undertake work that is complementary or additional to that of, another professional accountant, the proposed professional accountant shall:

- (a) Determine whether there are any reasons, professional or otherwise, for not accepting the engagement; and
- (b) Whenever possible, obtain the potential client's permission, preferably in writing, to initiate discussion with the existing professional accountant.

320.3 A1 Determining whether there are any reasons, professional or otherwise, for not accepting the engagement may reveal circumstances that create threats to compliance with the fundamental principles that cannot be eliminated or reduced to an acceptable level by the application of safeguards. For example, there may be a threat to professional competence and due care if a professional accountant accepts the engagement before knowing all the relevant facts.

320.3 A2 Examples of safeguards that may be available to address any such threat include:

- When replying to requests to submit tenders, stating in the tender that, before accepting the engagement, contact with the existing accountant will be requested. This

is so that inquiries may be made whether there are any reasons why the appointment should not be accepted.

- Asking the existing accountant to provide information on any facts or circumstances that the proposed professional accountant, in the existing accountant's opinion, needs to be aware of before deciding whether to accept the engagement.
- Obtaining necessary information from other sources.

320.3 A3 Depending on the nature of the engagement, direct communication with the existing accountant to establish the facts and circumstances regarding the proposed change may be necessary. Such communication may assist a professional accountant in deciding whether it would be appropriate to accept the engagement. For example, the apparent reason for the change in appointment may not fully reflect the facts. It may indicate disagreements with the existing accountant that may influence the decision to accept the appointment.

320.3 A4 A professional accountant may also be asked to undertake work that is complementary or additional to the work of the existing accountant. Such circumstances may create threats to professional competence and due care resulting from, for example, a lack of or incomplete information. An example of a safeguard is notifying the existing accountant of the proposed work as this would give the existing accountant the opportunity to provide any relevant information needed for the proper conduct of the work.

R320.4 When unable to communicate with the existing accountant, the proposed professional accountant shall take other reasonable steps to obtain information about any possible threats to compliance with the fundamental principles.

R320.5 When an existing professional accountant is asked to respond to a communication from a proposed accountant, the existing professional accountant shall:

- (a) Comply with relevant legal and other regulations governing such requests; and
- (b) Provide any such information honestly and unambiguously.

320.5 A1 An existing professional accountant is bound by confidentiality. Whether such a professional accountant is permitted or required to discuss the affairs of a client with a proposed professional accountant will depend on the nature of the engagement and on:

- (a) Whether the client's permission to do so has been obtained; or
- (b) The legal or ethical requirements relating to such communications and disclosure, which may vary by jurisdiction.

320.5 A2 Circumstances where the professional accountant is or may be required to disclose confidential information or where such disclosure may otherwise be appropriate are set out in paragraphs 110.8 A2 and 110.8 A3 of this Code.

Second Opinions

R320.6 When an entity seeking a second opinion from a professional accountant will not permit the professional accountant to communicate with the existing accountant, the professional accountant shall determine whether, taking all the circumstances into account, the

professional accountant may provide the second opinion sought and remain in compliance with the fundamental principles.

- 320.6 A1 Professional accountants may be asked to provide a second opinion on the application of accounting, auditing, reporting or other standards or principles to specific circumstances or transactions by or on behalf of a company or an entity that is not an existing client. The provision of a second opinion to an entity that is not an existing client may create threats to compliance with the fundamental principles. For example, there may be a threat to professional competence and due care in circumstances where the second opinion is not based on the same set of facts that were made available to the existing accountant or is based on inadequate evidence.
- 320.6 A2 The existence and significance of any threat created when a professional accountant is asked to provide such an opinion will depend on the circumstances of the request and all the other available facts and assumptions relevant to the expression of a professional judgment. Examples of safeguards that may be available to address any such threat include:
- Seeking client permission to contact the existing accountant;
 - Describing the limitations surrounding any opinion in communications with the client; and
 - Providing the existing accountant with a copy of the opinion.

Reliance on an Expert

R320.7 When a professional accountant intends to rely on the work of an expert, the professional accountant shall determine whether such reliance is warranted.

- 320.7 A1 Factors to consider when a professional accountant intends to rely on the advice or work of an expert include:
- Reputation.
 - Expertise.
 - Resources available.
 - Applicable professional and ethical standards.

Such information may be gained from prior association with the expert or from consulting others.

Section 330

Fees and Other Types of Remuneration

Scope

330.1 The level and nature of fees and other types of remuneration may be such that they cause threats to compliance with the fundamental principles. Section 330 sets out specific requirement and related application material in relation to applying the conceptual framework to fees and other types of remuneration.

Core Requirement and Related Application Material

R330.2 When deciding on the level and nature of fees to be charged to the client or considering any other type of remuneration, the professional accountant shall apply the conceptual framework to:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the significance of the threats; and
- (c) Apply safeguards to eliminate or reduce the threat to an acceptable level.

If safeguards cannot be applied to eliminate or reduce the threat to an acceptable level, the professional accountant shall eliminate the circumstances or relationship creating the threat.

330.2 A1 Professional accountants may face circumstances in relation to fees and other types of remuneration that create threats to compliance with the fundamental principles. Fee arrangements may cause threats to objectivity and professional competence and due care.

Specific Requirements and Related Application Material

Level of Fees

R330.3 When a professional accountant is pressured to quote a level of fees that impacts the ability of the professional accountant to perform professional services in accordance with professional standards, the professional accountant shall evaluate the significance of any threat so created and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level.

330.3 A1 When entering into negotiations regarding professional services, a professional accountant may quote whatever fee is considered appropriate. The fact that one professional accountant may quote a fee lower than another is not in itself unethical. Nevertheless, there may be threats to compliance with the fundamental principles arising from the level of fees quoted. Fee quotations may create a threat to professional competence and due care if the fee quoted is so low that it may be difficult to perform the engagement in accordance with applicable technical and professional standards for that price.

330.3 A2 Examples of safeguards that may be available to address any such threat include:

- Making the client aware of the terms of the engagement and, in particular, the basis on which fees are charged and which professional services are covered by the quoted fee; or
- Assigning appropriate time and qualified staff to the task.

Contingent Fees

R330.4 When a professional accountant performs a non-assurance service on the basis of a contingent fee arrangement, the professional accountant shall evaluate the significance of any threat so created and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level.

330.4 A1 Contingent fees are widely used for certain types of non-assurance engagements,¹ However, contingent fees may create threats to compliance with the fundamental principles, particularly a self-interest threat to objectivity, in certain circumstances. The existence and significance of such threats will depend on factors including:

- The nature of the engagement.
- The range of possible fee amounts.
- The basis for determining the fee.
- Whether the outcome or result of the transaction is to be reviewed by an independent third party.

330.4 A2 Examples of safeguards that may be available to address any such threat include:

- An advance written agreement with the client as to the basis of remuneration;
- Disclosure to intended users of the work performed by the professional accountant and the basis of remuneration;
- Quality control policies and procedures; or
- Review by an independent third party of the work performed by the professional accountant.

Referral Fees or Commissions

R330.5 A professional accountant shall evaluate the significance of any threat created and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level when:

- (a) The professional accountant receives a referral fee or commission in relation to goods or services provided to a client by a third party, unless such referral fee or commission is in relation to the purchase or sale of all or part of another firm; or
- (b) The professional accountant pays a referral fee to obtain a client.

330.5 A1 In certain circumstances, a professional accountant may receive a referral fee or commission relating to a client. For example, where the professional accountant does not provide the specific professional service required, a fee may be received for referring a continuing client to another professional accountant or other expert. A professional accountant may receive a commission from a third party (for example, a software vendor) in connection with the sale of goods or services to a client. Accepting such a referral fee or commission creates a self-interest threat to objectivity and professional competence and due care.

¹ Contingent fees for non-assurance services provided to audit clients and other assurance clients are discussed in Sections 400 to 499 and 500 to 599 of this Code.

- 330.5 A2 A professional accountant may also pay a referral fee to obtain a client, for example, where the client continues as a client of another professional accountant but requires specialist services not offered by the existing accountant. The payment of such a referral fee also creates a self-interest threat to objectivity and professional competence and due care.
- 330.5 A3 Examples of safeguards that may be available to address a threat created by the receipt or payment of a referral fee or commission include:
- Disclosing to the client any arrangements to pay a referral fee to another professional accountant for the work referred;
 - Disclosing to the client any arrangements to receive a referral fee for referring the client to another professional accountant; or
 - Obtaining advance agreement from the client for commission arrangements in connection with the sale by a third party of goods or services to the client.
- 330.5 A4 A professional accountant may purchase all or part of another firm on the basis that payments will be made to individuals formerly owning the firm or to their heirs or estates. Such payments are not regarded as referral fees or commissions for purpose of paragraph R330.5, including its related application material above.

Section 340

Gifts and Hospitality

Scope

340.1 Section 340 considers the giving and accepting of gifts and hospitality and how it may cause threats to compliance with the fundamental principles of independence, objectivity and professional behavior.

Core Requirement and Related Application Material

R340.2 When considering giving or accepting gifts and hospitality, the professional accountant shall apply the conceptual framework to:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the significance of the threats identified; and
- (c) Apply safeguards to eliminate or reduce the threats to an acceptable level.

If safeguards cannot be applied to eliminate or reduce threats to an acceptable level, the professional accountant shall eliminate the circumstances creating the threat.

340.2 A1 Professional accountants may face threats to compliance with the fundamental principles in relation to offers of gifts and hospitality from clients. For example, a self-interest or familiarity threat to objectivity may be created if a gift from a client is accepted; an intimidation threat to objectivity may result from the possibility of such offers being made public.

Specific Requirements and Related Application Material

R340.3 When a professional accountant, or an immediate or close family member of a professional accountant, is offered a gift or hospitality from a client, the professional accountant shall evaluate the significance of any threats and apply safeguards when necessary to eliminate the threats or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant shall not accept such an offer.

340.3 A1 The existence and significance of any threat created by an offer of a gift or hospitality from a client will depend on the nature, value, and intent of the offer. There are cases where a reasonable and informed third party, weighing all the specific facts and circumstances, would consider some gifts or hospitality to be trivial and inconsequential. In such cases, a professional accountant may conclude that the offer is made in the normal course of business without the specific intent to influence decision making or to obtain information and conclude that any threat to compliance with the fundamental principles is at an acceptable level.

Section 350

Custody of Client Assets

Scope of this Section

350.1 Section 350 considers the threats to compliance with the fundamental principles that professional accountants may face if they assume custody of clients monies or other assets.

Core Requirement

R350.2 In deciding whether to assume custody of client assets, the professional accountant shall apply the conceptual framework to:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the significance of the threats identified; and
- (c) Apply safeguards to eliminate or reduce the threats to an acceptable level.

If safeguards cannot be applied to eliminate or reduce threats to an acceptable level, the professional accountant shall eliminate the circumstance creating the threat or decline or discontinue the engagement.

Specific Requirements and Related Application Material

R350.3 A professional accountant shall not assume custody of client monies or other assets unless permitted to do so by law and, if so, in compliance with any additional legal duties imposed in relation to the holding of such assets.

350.3 A1 The holding of client assets creates threats to compliance with the fundamental principles; for example, there is a self-interest threat to professional behavior and there may be a self-interest threat to objectivity arising from holding client assets. A professional accountant may be bound by law that establishes who may take custody of client monies or other assets and under what conditions such custody may be taken.

R350.4 A professional accountant entrusted with money or other assets belonging to others shall:

- (a) Make appropriate inquiries about the source of client assets and consider legal and regulatory obligations as part of client and engagement acceptance procedures in relation to such services;
- (b) Keep such assets separately from personal or firm assets;
- (c) Use such assets only for the purpose for which they are intended;
- (d) At all times be ready to account for those assets and any income, dividends, or gains generated, to any persons entitled to such accounting; and
- (e) Comply with all relevant laws and regulations relevant to the holding of and accounting for such assets.

350.4 A1 Inquiries about the source of client assets may reveal, for example, that the assets were derived from illegal activities, such as money laundering. In such situations, a threat to compliance with the fundamental principles would be created and the professional accountant may consider seeking legal advice.

Part C2 Independence for Audit and Review Engagements

Section 400

Application of Conceptual Framework to Independence for Audits and Reviews

Terms Used

400.1 In Part C2:

- (a) “Audit,” “audit team,” “audit engagement,” “audit client” and “audit report” include review, review team, review engagement, review client and review report, respectively;
- (b) “Audit client” includes related entities of the client, as set out in paragraph R400.15; and
- (c) “Professional accountant” refers to professional accountants in public practice and the firms within which they practice.
- (d) “Engagement period”:
 - (ii) Starts when the audit team begins to perform audit services; and
 - (iii) Ends when the audit report is issued.If the engagement is of a recurring nature, the engagement period ends at the later of:
 - (iv) The notification by either party that the professional relationship has terminated; or
 - (v) The issuance of the final audit report.

Scope of this Part

- 400.2 Part C2 sets out requirements and provides guidance for professional accountants in public practice with respect to maintaining independence when performing audit engagements. These engagements are assurance engagements in which a professional accountant expresses a conclusion on financial statements. Such engagements comprise audit engagements to report on a complete set of financial statements or on a single financial statement.
- 400.3 Part C2 describes specific circumstances and relationships that create or may create threats to independence. It also describes the potential threats and the types of safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level and identifies certain situations where no safeguards could reduce the threats to an acceptable level. It does not describe all of the circumstances and relationships that create or may create a threat to independence. Applying the conceptual framework requires a professional accountant to evaluate the implications of similar, but different, circumstances and relationships and determine whether safeguards, including the safeguards in paragraphs 300.3 A11 to A14, can be applied when necessary to eliminate the threats to independence or reduce them to an acceptable level.
- 400.4 Independence requirements for assurance engagements that are not audit engagements are addressed in Part C3.

Reports with Restricted Use and Distribution

400.5 In certain circumstances, an audit report may include a restriction on use and distribution. In such circumstances, the independence requirements in this part may be modified as provided in paragraphs XXX.X to XXX.XX, provided that the conditions set out in those paragraphs are also met. Such modifications are not permitted in the case of an audit of financial statements required by law or regulation.

Core Requirements and Related Application Material

R400.6 When performing an audit engagement, a professional accountant shall, both during the engagement period and the period covered by the financial statements:

- (a) Be independent of the audit client; and
- (b) Comply with each of the provisions of Part C2.

R400.7 If an entity becomes an audit client during or after the period covered by the financial statements on which the firm will express an opinion, the firm shall determine whether any threats to independence are created by:

- (a) Financial or business relationships with the audit client during or after the period covered by the financial statements but before accepting the audit engagement; or
- (b) Previous services provided to the audit client by the firm or network firm.

R400.8 If the previous services described in paragraph R400.7 (b) would not have been permitted during the period of the audit engagement, the firm shall evaluate any threat to independence created by the service. If a threat is not at an acceptable level, the audit engagement shall only be accepted if safeguards are applied to eliminate any threats or reduce them to an acceptable level.

400.8 A1 Examples of such safeguards include:

- Not including personnel who provided the non-assurance service as members of the audit team;
- Having a professional accountant review the audit and non-assurance work as appropriate; or
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

R400.9 A professional accountant shall achieve and maintain independence by:

- (a) Identifying threats to compliance with the fundamental principles;
- (b) Evaluating the significance of the threats identified; and
- (c) Either:
 - (i) Applying safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level, or

- (ii) When the professional accountant determines that appropriate safeguards are not available or cannot be applied to eliminate the threats or reduce them to an acceptable level, eliminating the circumstance or relationship creating the threat or declining or ending the engagement.

R400.10 In applying the provisions of paragraph R400.9 when performing an audit engagement, a professional accountant shall:

- (a) When evaluating the significance of threats to independence, take qualitative as well as quantitative factors into account;
- (b) If a determination has been made that the threats are not at an acceptable level, and the decision to be made is whether to accept an engagement or include a particular individual on the audit team, determine whether safeguards are available to eliminate the threats or reduce them to an acceptable level;
- (c) If the decision is whether to continue an audit engagement, determine whether:
 - (i) Any existing safeguards will continue to be effective to eliminate the threats or reduce them to an acceptable level;
 - (ii) Other safeguards will need to be applied; or
 - (iii) The engagement needs to be terminated; and
- (e) Whenever new information about a threat to independence comes to the attention of the professional accountant during an audit engagement, evaluate the significance of that threat in accordance with the conceptual framework approach.

The following highlighted paragraphs have been included for the sake of completeness. The Task Force is deferring making any recommendations on the paragraphs for the time being. See Agenda Item 5-A section C *Identification of a Firm's or an Individual's Responsibility*.

Specific Requirements and Related Application Material

Establishing Policies and Procedures for Compliance with this Code

- R400.11** A firm shall establish, implement and maintain policies and procedures, appropriately documented and communicated within the firm, to:
- (a) Identify those individuals with appropriate authority who, in particular circumstances, are responsible for taking appropriate action on behalf of the firm in accordance with the requirements of this Code;
 - (b) Maintain compliance with this Code by relevant individuals within the firm and, as applicable, their immediate family; and
 - (c) Require communication of threats to and breaches of independence to relevant individuals who are responsible for taking appropriate action on behalf of the firm in accordance with the requirements of this Code.

Establishing policies and procedures for compliance with this code

400.11 A1 Individuals who are responsible for taking appropriate action on behalf of the firm in accordance with the requirements of this Code may include:

- (a) The engagement partner.
- (b) Senior individuals responsible for ethics or independence matters for the firm.
- (c) Any other individual within the firm identified as a responsible individual in relation to a particular matter.

400.11 A2 Policies that enable identification of responsible individuals may differ depending on the size, structure and organization of a firm. In addition, *International Standards on Auditing (ISAs)* require the engagement partner to form a conclusion on compliance with the independence requirements that apply to the engagement.

400.11 A3 The identification of individuals who are responsible for taking appropriate action on behalf of the firm does not relieve a professional accountant of individual responsibility to comply with the Code.

Network Firms

R400.12 An entity that is a network firm, irrespective of whether that entity itself meets the definition of a firm, shall be independent of any audit clients of the other firms within the network, unless an exception is otherwise provided by this Code.

R400.13 When associated with a larger structure of other firms and entities, a firm shall:

- (a) Use professional judgment to determine whether a network is created by such a larger structure;
- (b) Consider whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the other firms and entities in the larger structure are associated in such a way that a network exists; and
- (c) Apply such judgment consistently throughout such a larger structure.

400.13 A1 The independence requirements in Part C2 that apply to a network firm apply to any entity, such as a consulting practice or professional law practice, that meets the definition of a network firm irrespective of whether the entity itself meets the definition of a firm.

400.13 A2 Whether the larger structures that are established by firms create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, where a larger structure is aimed at co-operation and the firms share a common brand name, a common system of quality control or significant professional resources the larger structure is a network.

400.13 A3 Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure it is a network. However, the sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals or

training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product does not in itself create a network.

- 400.13 A4 Where the larger structure is aimed at co-operation and the entities within the structure share common ownership, control or management it is a network. This could be achieved by contract or other means.
- 400.13 A5 Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures it is a network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.
- 400.13 A6 Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy it is a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision of a professional service.
- 400.13 A7 Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name it is a network. A common brand name includes common initials or a common name. A firm is using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name when a partner of the firm signs an audit report.
- 400.13 A8 Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms. Accordingly, if care is not taken in how a firm describes such memberships a perception may be created that the firm belongs to a network.
- 400.13 A9 Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources it is a network. Professional resources include:
- Common systems that enable firms to exchange information such as client data, billing and time records.
 - Partners and staff.
 - Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements.
 - Audit methodology or audit manuals.
 - Training courses and facilities.
- 400.13 A10 The determination of whether the professional resources shared are significant, and therefore the firms are network firms, is made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor. Where however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical department is created within the larger

structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

R400.14 In some circumstances, a firm or network may sell a component of its practice where the sales agreement provides that, for a limited period of time, the component may continue to use the name of the firm or the network, or an element of the name, even though it is no longer connected to the firm or the network. In such circumstances, the affected entities shall determine how to disclose that either one or both of them is not part of the firm or the network when presenting themselves to outside parties.

400.14 A1 In the circumstances set out in paragraph R400.13, while the two entities may be practicing under a common name, the facts are such that they do not belong to a larger structure aimed at co-operation and are, therefore, not network firms. The continued use of the name, or element of the name, without disclosure, by an entity that is no longer part of the firm or the network may be misleading to outside parties.

Related Entities

R400.15 In Part C2,

- (a) In the case of an audit client that is a listed entity, references to an audit client include related entities of the client (unless otherwise stated); and
- (b) In the case of all other audit clients,
 - (i) References to an audit client include only those related entities over which the client has direct or indirect control; and
 - (ii) When the audit team knows or has reason to believe that a relationship or circumstance involving another related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team shall include that related entity when identifying and evaluating threats to independence and applying appropriate safeguards.

Merger and Acquisitions

R400.16 In some circumstances, an entity may become a related entity of an audit client as a result of a merger or acquisition. In such circumstances, the firm shall identify and evaluate previous and current interests and relationships with the related entity that, taking into account available safeguards, could affect its independence and therefore its ability to continue the audit engagement after the effective date of the merger or acquisition.

R400.17 In the circumstances described in paragraph R400.16 the following provisions shall apply:

- (a) The firm shall take steps necessary to terminate, by the effective date of the merger or acquisition, any current interests or relationships that are not permitted under this Code.
- (b) Notwithstanding the provisions of sub-paragraph (a), if such a current interest or relationship cannot reasonably be terminated by the effective date of the merger or acquisition, the firm shall:

- (i) Evaluate the threat that is created by such interest or relationship; and
- (ii) Discuss with those charged with governance the reasons why the interest or relationship cannot reasonably be terminated by the effective date of the merger or acquisition and the evaluation of the significance of the threat.

400.17 A1 Reasonable termination of a current interest or relationship by the effective date of the merger or acquisition may not be possible. This may be because the related entity is unable by the effective date to effect an orderly transition to another service provider of a non-assurance service provided by the firm. In such circumstances, the significance of the threat to objectivity created may depend upon factors such as:

- The nature and significance of the interest or relationship;
- The nature and significance of the related entity relationship (for example, whether the related entity is a subsidiary or parent); and
- The length of time until the interest or relationship can reasonably be terminated.

R400.18 If those charged with governance request the firm to continue as the auditor, the firm shall do so only if:

- (a) The interest or relationship will be terminated as soon as reasonably possible and in all cases within six months of the effective date of the merger or acquisition;
- (b) Any individual who has such an interest or relationship, including one that has arisen through performing a non-assurance service that would not be permitted by Part C2, will not be a member of the engagement team for the audit or the individual responsible for the engagement quality control review; and
- (c) Appropriate transitional measures will be applied, as necessary, and discussed with those charged with governance.

400.18 A1 Examples of appropriate transitional measures that might be implemented to meet the requirements of paragraph R400.18 include:

- Having a professional accountant review the audit or non-assurance work as appropriate;
- Having a professional accountant, who is not a member of the firm, expressing the opinion on the financial statements, perform a review that is equivalent to an engagement quality control review; or
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

R400.19 In some circumstances, notwithstanding the provisions of paragraphs R400.16 to R400.18, when the firm:

- (a) Has completed a significant amount of work on the audit prior to the effective date of the merger or acquisition; and
- (b) Is able to complete the remaining audit procedures within a short period of time,

those charged with governance may request the firm to complete the audit while continuing with an interest or relationship identified in paragraph R400.16. In such circumstances, the firm shall do so only if it:

- (a) Has evaluated the significance of the threat created by such interest or relationship and discussed the evaluation with those charged with governance;
- (b) Complies with the requirements of paragraph R400.18 (a) to (c); and
- (c) Ceases to be the auditor no later than the issuance of the audit report.

R400.20 When addressing previous and current interests and relationships described in paragraph R400.16 the firm shall determine whether, even if all the requirements paragraphs R400.18 and R400.19 could be met, the interests and relationships create threats that would remain so significant that objectivity would be compromised and, if so, the firm shall cease to be the auditor.

R400.21 The professional accountant shall document:

- (a) Any interests or relationships described in paragraphs R400.16 and R400.19 that will not be terminated by the effective date of the merger or acquisition and the reasons why they will not be terminated;
- (b) The transitional measures applied;
- (c) The results of the discussion with those charged with governance, and
- (d) The rationale as to why the previous and current interests and relationships do not create threats that would remain so significant that objectivity would be compromised.

Documentation

R400.22 A professional accountant shall document conclusions regarding compliance with independence requirements, and the substance of any relevant discussions that support those conclusions. Accordingly:

- (a) When safeguards are required to reduce a threat to an acceptable level, the professional accountant shall document the nature of the threat and the safeguards in place or applied that reduce the threat to an acceptable level; and
- (b) When a threat required significant analysis to determine whether safeguards were necessary and the professional accountant concluded that they were not because the threat was already at an acceptable level, the professional accountant shall document the nature of the threat and the rationale for the conclusion.

400.22 A1 Paragraph R400.22 sets out specified documentation requirements, however, the absence of documentation is not a determinant of lack of independence nor whether a professional accountant considered a particular matter.

Those Charged with Governance

R400.23 In complying with requirements in this section to communicate with those charged with governance, the firm shall determine, having regard to the nature and importance of the particular circumstances and matter to be communicated, the appropriate person(s) within

the entity's governance structure with whom to communicate. If the firm communicates with a sub-group of those charged with governance, for example, an audit committee or an individual, the firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

400.23 A1 Applicable auditing standards, law or regulation may require regular communication between the firm and those charged with governance of the audit client regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence. Even when not required, such communication enables those charged with governance to:

- Consider the firm's judgments in identifying and evaluating threats to independence,
- Consider the appropriateness of safeguards applied to eliminate them or reduce them to an acceptable level, and
- Take appropriate action.

Such communication can be particularly helpful with respect to intimidation and familiarity threats.

400.23 A2 Factors to consider when communicating with those charged with governance in accordance with the provisions of this Code, include:

- The nature and importance of the particular circumstances and matter to be communicated, and
- The appropriate person or persons within the entity's governance structure with whom to communicate. For example:
 - Whether it is sufficient to communicate with a subgroup of those charged with governance, such as an audit committee or an individual; or
 - Whether it is also necessary to communicate with all of those charged with governance so that they are adequately informed.

Public Interest Entities

400.24 A1 Part C2 contains additional provisions that reflect the extent of public interest in certain entities. Firms and member bodies are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include:

- The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples may include financial institutions, such as banks and insurance companies, and pension funds;
- Size; and
- Number of employees.

Section 401

Breach of an Independence Provision

Requirements and Related Application Guidance

When a Firm Identifies a Breach

- R401.1** Notwithstanding any other provisions of Part C2, if a firm concludes that a breach of any of those provisions has occurred, the firm shall:
- (a) Terminate, suspend or eliminate the interest or relationship that caused the breach and address the consequences of the breach;
 - (b) Consider whether there are any legal or regulatory requirements that apply with respect to the breach and, if so, shall comply with those requirements and shall also consider reporting the breach to a member body, relevant regulator or oversight authority if such reporting is common practice or is expected in the particular jurisdiction;
 - (c) Promptly communicate, in accordance with its policies and procedures, the breach to:
 - (i) The engagement partner;
 - (ii) Those with responsibility for the policies and procedures relating to independence;
 - (iii) Other relevant personnel in the firm, and, where appropriate, the network; and
 - (iv) Those subject to the independence requirements who need to take appropriate action.
 - (d) Evaluate the significance of the breach and its impact on the firm's objectivity and ability to issue an audit report;
 - (e) Depending on the significance of the breach, determine whether to terminate the audit engagement or whether it may be possible to take action that satisfactorily addresses the consequences of the breach and whether such action can be taken and is appropriate in the circumstances. In making this determination, the firm shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken and all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude that the firm's objectivity would be compromised and therefore the firm is unable to issue an audit report.
- 401.1 A1 A breach of a provision of Part 2C section may occur despite the firm having policies and procedures designed to provide it with reasonable assurance that independence is maintained. A consequence of a breach may be that termination of the audit engagement is necessary.
- 401.1 A2 When a breach is identified, the significance and impact of the breach on the firm's objectivity and ability to issue an audit report will depend on factors such as:
- The nature and duration of the breach;
 - The number and nature of any previous breaches with respect to the current audit

engagement;

- Whether a member of the audit team had knowledge of the interest or relationship that caused the breach;
- Whether the individual who caused the breach is a member of the audit team or another individual for whom there are independence requirements;
- If the breach relates to a member of the audit team, the role of that individual;
- If the breach was caused by the provision of a professional service, the impact of that service, if any, on the accounting records or the amounts recorded in the financial statements on which the firm will express an opinion; and
- The extent of the self-interest, advocacy, intimidation or other threats created by the breach.

401.1 A3 Depending upon the significance of the breach, examples of actions that the firm may take to satisfactorily address the breach include:

- Removing the relevant individual from the audit team;
- Conducting an additional review of the affected audit work or re-performing that work to the extent necessary, in either case using different personnel;
- Recommending that the audit client engage another firm to review or re-perform the affected audit work to the extent necessary; and
- Where the breach relates to a non-assurance service that affects the accounting records or an amount that is recorded in the financial statements, engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

R401.2 If the firm determines that action cannot be taken to satisfactorily address the consequences of the breach, the firm shall inform those charged with governance as soon as possible and take the steps necessary to terminate the audit engagement in compliance with any applicable legal or regulatory requirements. Where termination is not permitted by law or regulation, the firm shall comply with any reporting or disclosure requirements.

R401.3 If the firm determines that action can be taken to satisfactorily address the consequences of the breach, the firm shall discuss with those charged with governance, as soon as possible or in accordance with specified alternative timing for reporting less significant breaches:

- (a) The significance of the breach, including its nature and duration;
- (b) How the breach occurred and how it was identified;
- (c) The action taken or proposed to be taken and the firm's rationale for why the action will satisfactorily address the consequences of the breach and enable it to issue an audit report;
- (d) The conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for that conclusion; and

- (e) Any steps that the firm has taken or proposes to take to reduce or avoid the risk of further breaches occurring.

Communication with Those Charged with Governance

- R401.4** The firm shall communicate in writing with those charged with governance all matters discussed in accordance with paragraphs R401.1 to R401.3 and obtain the concurrence of those charged with governance that action can be, or has been, taken to satisfactorily address the consequences of the breach.
- R401.5** The communication shall include a description of the firm's policies and procedures relevant to the breach designed to provide it with reasonable assurance that independence is maintained and any steps that the firm has taken, or proposes to take, to reduce or avoid the risk of further breaches occurring.
- R401.6** If those charged with governance do not concur that the action satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to terminate the audit engagement in accordance with the provisions set out in paragraph R401.2.

Breaches Prior to the Issuance of the Previous Audit Report

- R401.7** If the breach occurred prior to the issuance of the previous audit report, in evaluating the significance of the breach and its impact on the firm's objectivity and its ability to issue an audit report in the current period, the firm shall comply with the provisions of Part C2 of the Code that are relevant to the breach.
- R401.8** The firm shall consider the impact of the breach, if any, on the firm's objectivity in relation to any previously issued audit reports, and the possibility of withdrawing such audit reports, and discuss the matter with those charged with governance.

Documentation

- R401.9** The firm shall document the breach, the action taken, key decisions made and all the matters discussed with those charged with governance and any discussions with a member body, relevant regulator or oversight authority.
- R401.10** When the firm continues with the audit engagement, the matters to be documented shall also include the conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach such that the firm could issue an audit report.

Section 500 - Independence: Relationships

Section 510

Financial Relationships

Terms Used

510.1 In Section 511, “materiality” is used to refer to a financial interest, loan, or guarantee, or the significance of a business relationship. For the purpose of determining whether such an interest is material to an individual, the combined net worth of the individual and the individual’s immediate family members may be taken into account.

Scope of this Section

510.2 Professional accountants may face threats to compliance with the fundamental principles in relation to financial relationships that may exist between them and their audit clients. Section 511 and 512 sets out specific requirements and related application material in relation to applying the conceptual framework to in relation to such financial relationships.

Section 511

Financial Interests

Core Requirement and Related Application Material

R511.1 When considering financial interests with an audit client which may give rise to threats to the fundamental principle of objectivity, the professional accountant shall apply the conceptual framework to:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the significance of the threats identified; and
- (c) Apply safeguards to eliminate or reduce the threats to an acceptable level.

If safeguards cannot be applied to eliminate or reduce threats to an acceptable level, the professional accountant shall eliminate the circumstance creating the threat or decline or discontinue the engagement.

511.1 A1 Holding a financial interest in an audit client may create a self-interest threat to independence. The existence and significance of any threat created depends on:

- (a) The role of the person holding the financial interest,
- (b) Whether the financial interest is direct or indirect, and
- (c) The materiality of the financial interest.

511.1 A2 Financial interests may be held through an intermediary (for example, a collective investment vehicle, estate or trust). The determination of whether such financial interests are direct or indirect will depend upon whether the beneficial owner has control over the intermediary or the ability to influence its investment decisions. When control over the intermediary or the ability to influence investment decisions exists, this Code defines that financial interest to be a direct financial interest. Conversely, when the beneficial owner of the financial interest has

no control over the intermediary or ability to influence its investment decisions, this Code defines that financial interest to be an indirect financial interest.

Specific Requirements and Related Application Material

Financial Interests Held by the Firm, Audit Team Members, and Other Members of the Firm

R511.2 A direct financial interest or a material indirect financial interest in an audit client shall not be held by:

- (a) The firm or a network firm;
- (b) A member of the audit team, or a member of that individual's immediate family;
- (c) Any other partner in an office in which an engagement partner practices in connection with an audit engagement, or an immediate family member of that other partner; or
- (d) Any other partners and managerial employees who provide non-audit services to an audit client, except for those whose involvement is minimal, or their immediate family members.

R511.3 Notwithstanding the requirements set out in paragraph R511.2, the immediate family member described in sub-paragraphs R511.2 (b), (c) and (d) may hold a direct financial interest or a material indirect financial interest in an audit client, provided that:

- (a) The financial interest is received as a result of the immediate family member's employment rights;
- (b) When the immediate family member has or obtains the right to dispose of the financial interest or, in the case of a stock option, the right to exercise the option, the financial interest shall be disposed of or forfeited as soon as practicable; and
- (c) When necessary, the firm applies safeguards to eliminate any threat to independence or reduce it to an acceptable level.

511.3 A1 The office in which the engagement partner practices in connection with an audit engagement is not necessarily the office to which that partner is assigned. When the engagement partner is located in a different office from that of the other members of the audit team, the determination of the office in which the partner practices in connection with the engagement requires the use of professional judgment.

Financial Interests Held as Trustee

R511.4 A direct financial interest or a material indirect financial interest in an audit client shall not be held, as trustee, by any of the parties to which paragraph R511.2 refers, unless:

- (a) Neither the trustee, nor an immediate family member of the trustee, nor the firm nor a network firm are beneficiaries of the trust;
- (b) The interest in the audit client held by the trust is not material to the trust;
- (c) The trust is not able to exercise significant influence over the audit client; and

- (d) Neither the trustee, nor an immediate family member of the trustee, nor the firm nor a network firm can significantly influence any investment decision involving a financial interest in the audit client.)

R511.5 When an entity has a controlling interest in an audit client and the audit client is material to the entity, neither the firm, nor a network firm, nor a member of the audit team, nor a member of that individual's immediate family shall hold a direct or material indirect financial interest in that entity.

Other Financial Interests

R511.6 A firm, or a network firm, or a member of the audit team, or a member of that individual's immediate family shall not hold a financial interest in an entity when an audit client also has a financial interest in that entity, unless:

- (a) The financial interests are immaterial to the firm, the network firm, the member of the audit team, that individual's immediate family and the audit client, as the case may be; and
- (b) The audit client cannot exercise significant influence over the entity.

R511.7 Notwithstanding the requirements set out in paragraph R511.6 (a), an individual may participate on the audit team for an audit client if, prior to that individual becoming a member of the audit team, the individual or the member of that individual's immediate family, either disposes of:

- (a) The financial interest that would otherwise not be permitted; or
- (b) A sufficient amount of the financial interest that would otherwise not be permitted, so that the remaining interest is no longer material.

Unintended Acquisition of Interests

R511.8 If a firm, a network firm or a partner or employee of the firm or a network firm, or a member of that individual's immediate family, receives a direct financial interest or a material indirect financial interest in an audit client by way of an inheritance, gift, as a result of a merger or in similar circumstances and such interest would not otherwise be permitted to be held under this section then:

- (a) If the interest is received by the firm or a network firm, or a member of the audit team or a member of the immediate family of that individual, the financial interest shall be disposed of immediately, or a sufficient amount of an indirect financial interest shall be disposed of so that the remaining interest is no longer material; or
- (b) (i) If the interest is received by an individual who is not a member of the audit team, or by an immediate family member of that individual, the financial interest shall be disposed of as soon as possible, or a sufficient amount of an indirect financial interest shall be disposed of so that the remaining interest is no longer material, and
- (ii) Pending the disposal of the financial interest, the firm shall determine whether safeguards are necessary.

R511.9 A firm shall evaluate the significance of any threat created by the following financial interests and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level:

- (a) If a member of the audit team has a close family member who the audit team member knows has a direct financial interest or a material indirect financial interest in the audit client. (Ref: Para. 511.9 A1)
- (b) If a firm's or a network firm's retirement benefit plan holds a direct or material indirect financial interest in an audit client.
- (c) If a member of the audit team, or a member of that individual's immediate family, or the firm or a network firm, has a financial interest in an entity when a director or officer or controlling owner of the audit client is also known to have a financial interest in that entity. (Ref: Para. 511.9 A2)
- (d) When a member of the audit team knows that a financial interest in the audit client is held by other individuals including:
 - (i) Partners and professional employees of the firm or network firm, other than those who are specifically not permitted to hold such financial interests by paragraph R511.2, or their immediate family members; and
 - (ii) Individuals with a close personal relationship with a member of the audit team. (Ref: Para 511.9 A3)

511.9 A1 A self-interest threat may be created if a member of the audit team has a close family member who the audit team member knows has a direct financial interest or a material indirect financial interest in the audit client. The significance of any threat created depends on factors such as:

- The nature of the relationship between the member of the audit team and the close family member; and
- The materiality of the financial interest to the close family member.

Examples of such safeguards which may be applied when necessary to eliminate the threat or reduce it to an acceptable level include:

- The close family member disposing, as soon as practicable, of all of the financial interest or disposing of a sufficient portion of an indirect financial interest so that the remaining interest is no longer material;
- Having a professional accountant review the work of the member of the audit team; or
- Removing the individual from the audit team.

511.9 A2 Self-interest, familiarity, or intimidation threat may be created if a member of the audit team, or a member of that individual's immediate family, or the firm, or a network firm has a financial interest in an entity when a director or officer or controlling owner of the audit client is also known to have a financial interest in that entity. The existence and significance of any threat may depend upon factors such as:

- The role of the professional on the audit team;

- Whether ownership of the entity is closely or widely held;
- Whether the interest gives the investor the ability to control or significantly influence the entity; and
- The materiality of the financial interest.

Examples of safeguards that may be applied when necessary to eliminate the threat or reduce it to an acceptable level include:

- Removing the member of the audit team with the financial interest from the audit team; or
- Having a professional accountant review the work of the member of the audit team.

511.9 A3 Paragraph R511.9 (d) addresses the situation when a member of the audit team knows that a financial interest in the audit client is held by other individuals including:

- (a) Partners and professional employees of the firm or a network firm who are not otherwise prohibited from holding a financial interest, or their immediate family members; and
- (b) Individuals with a close personal relationship with a member of the audit team.

Whether these interests create a self-interest threat may depend on factors such as:

- The firm's organizational, operating and reporting structure; and
- The nature of the relationship between the individual and the member of the audit team.

511.9 A4 Applying the conceptual framework requires the firm to evaluate the significance of any threat and evaluate any safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Removing the member of the audit team with the personal relationship from the audit team;
- Excluding the member of the audit team from any significant decision-making concerning the audit engagement; or
- Having a professional accountant review the work of the member of the audit team.

Section 512

Loans and Guarantees

Core Requirement and Related Application Material

R512.1 When considering loans and guarantees to or from an audit client which may give rise to threats to the fundamental principle of objectivity as considered in this Section, the professional accountant shall apply the conceptual framework to:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the significance of the threats identified; and
- (c) Apply safeguards to eliminate or reduce the threats to an acceptable level.

If safeguards cannot be applied to eliminate or reduce threats to an acceptable level, the professional accountant shall eliminate the circumstance creating the threat or decline or discontinue the engagement.

- 512.1 A1 A loan or a guarantee of a loan between a professional accountant and an audit client may create self-interest, intimidation or familiarity threats.

Specific Requirements and Related Application Material

Loans and Guarantees with Bank or Similar Institution

R512.2 A firm, a network firm, a member of the audit team, or a member of that individual's immediate family shall not accept a loan, or a guarantee of a loan, from an audit client that is a bank or a similar institution unless the loan or guarantee is made under normal lending procedures, terms and conditions.

512.2 A1 If a loan to a firm or network firm from an audit client that is a bank or similar institution is made under normal lending procedures, terms and conditions and it is material to the audit client or firm receiving the loan, it may be possible to apply safeguards to reduce the self-interest threat to an acceptable level. An example of such a safeguard is having the work reviewed by a professional accountant from a network firm that is neither involved with the audit nor received the loan.

512.2 A2 A loan, or a guarantee of a loan, from an audit client that is a bank or a similar institution to a member of the audit team, or a member of that individual's immediate family, may not create a threat to independence if the loan or guarantee is made under normal lending procedures, terms and conditions. Examples of such loans include: home mortgages; bank overdrafts; car loans; and credit card balances.

Loans and Guarantees with Client That Is Not a Bank or Similar Institution

R512.3 A firm, a network firm, a member of the audit team, or a member of that individual's immediate family, shall not accept a loan from, or have a borrowing guaranteed by, an audit client that is not a bank or similar institution, unless the loan or guarantee is immaterial to both: (i) the firm or the member of the audit team and the immediate family member; and (ii) the client.

R512.4 A firm, a network firm, a member of the audit team, or a member of that individual's immediate family, shall not make or guarantee a loan to, an audit client that is not a bank or similar institution, unless the loan or guarantee is immaterial to both: (i) the firm or the member of the audit team and the immediate family member; and (ii) the client.

Deposits or brokerage accounts

R512.5 A firm, a network firm, a member of the audit team, or a member of that individual's immediate family, shall not have deposits or a brokerage account with an audit client that is a bank, broker or similar institution, unless the deposit or account is held under normal commercial terms.

Section 520

Other Relationships

Scope of this Section

520.1 In addition to financial relationships there are other relationships between a professional accountant and an audit client which may cause threats to compliance with the fundamental principles. Section 520 sets out core and specific requirements and related application material in relation to these other relationships.

Section 521

Business Relationships

Core Requirement and Related Application Material

R521.1 When considering whether business relationships between a professional accountant and an audit client create a threat to compliance with the fundamental principles, the professional accountant shall:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the significance of the threats identified; and
- (c) Apply safeguards to eliminate or reduce the threats to an acceptable level in relation to threats to independence arising from business relationships with an audit client.

If safeguards cannot be applied to eliminate or reduce threats to an acceptable level the professional accountant shall eliminate the circumstance creating the threat or decline or discontinue the engagement.

521.1 A1 A business relationship between a professional accountant and an audit client may create self-interest, intimidation or familiarity threats.

Specific Requirements and Related Application Material

Firm or Audit Team Member Relationships

R521.2 The firm, a network firm or a member of the audit team shall not have a close business relationship with an audit client or its management unless the financial interest is immaterial and the business relationship is insignificant to the firm, the network firm or the team member, as the case may be, and the client or its management.

R521.3 If an immediate family member of a member of the audit team has a close business relationship with an audit client or its management, the firm shall evaluate the significance of any threat created and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level.

Common Interests in Closely-Held Entities

R521.4 The firm, a network firm, a member of the audit team, or a member of that individual's immediate family shall not have a business relationship involving the holding of an interest in a closely-held entity when the audit client of the firm or a director or officer of the client, or any group thereof, also holds an interest in that entity, unless:

- (a) The business relationship is insignificant to the firm, the network firm, the member of the audit team and the immediate family member, and the client;
- (b) The financial interest is immaterial to the investor or group of investors; and
- (c) The financial interest does not give the investor, or group of investors, the ability to control the closely-held entity.

521.4 A1 Examples of a close business relationship between a firm, a network firm or a member of the audit team, or a member of that individual's immediate family, and the audit client or its management, arising from a commercial relationship or common financial interest include:

- Having a financial interest in a joint venture with either the client or a controlling owner, director, officer or other individual who performs senior managerial activities for that client.
- Arrangements to combine one or more services or products of the firm or the network firm with one or more services or products of the client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm or the network firm distributes or markets the client's products or services, or the client distributes or markets the firm's or the network firm's products or services.

Purchase of Goods or Services

R521.5 In some circumstances, a firm, a network firm, a member of the audit team, or a member of that individual's immediate family may purchase goods or services from an audit client in the normal course of business and at arm's length. In such circumstances, the firm shall consider the nature and magnitude of the transaction in the evaluation of the significance of any threat created and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level.

521.5 A1 Examples of such safeguards include:

- Eliminating or reducing the magnitude of the transaction; or
- Removing the individual from the audit team.