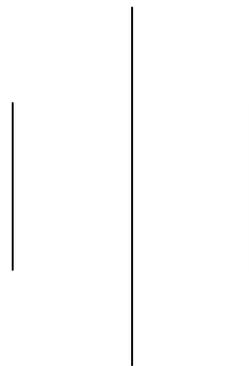


GUIDANCE NOTE
ON
INDEPENDENCE OF PROFESSIONAL ACCOUNTANTS
(GN 201)



Approved by:
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GUIDANCE NOTE ON INDEPENDENCE OF PROFESSIONAL ACCOUNTANTS

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The following is the text of the Guidance Note on Independence of auditors issued by the Auditing Standards Board of Nepal.

1. INTRODUCTION

- 1.1. This Guidance Note aims to clarify the meaning of independence while members perform their duties as Professional Accountants. Professional integrity and independence is an essential characteristic of all the professions but is more so in the case of accountancy profession. Independence implies that the judgement of a person is not subordinated to the wishes or direction of another person who might have engaged him, or to his own self-interest. This document shall provide guidance to members about the specific circumstances and relationships that may create threats to independence. The Guidance Note also provides safeguards that should be employed by the Professional Accountants to mitigate the risk arising from such circumstances and relationship leading to the threats to independence.
- 1.2. It is not possible to define "independence" precisely. Rules of professional conduct dealing with independence are framed primarily with a certain objective. The rules themselves cannot create or ensure the existence of independence. Independence is a condition of mind as well as personal character and should not be confused with the superficial and visible standards of independence which are sometimes imposed by law. These legal standards may be relaxed or strengthened but the quality of independence remains unaltered.
- 1.3. There are two interlinked perspectives of independence of Auditors, one, independence of mind; and two, independence in appearance.

The Code of Ethics for Professional Accountants, issued by International Federation of Accountants (IFAC) defines the term 'independence' as follows:

"Independence is:

- (a) Independence of mind – the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and
 - (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's integrity, objectivity or professional skepticism had been compromised of."
- 1.4. Independence of the Professional Accountant has not only to exist in fact, but also appear to so exist to all reasonable persons. The relationship between the Professional Accountant and his client should be such that firstly, he is himself satisfied about his

independence and secondly, no unbiased person would be forced to the conclusion that, on an objective assessment of the circumstances, there is likely to be an abridgement of the Professional Accountants' independence. To ensure independence, Code of Ethics for Professional Accountants issued by International Federation of Accountants and paragraphs 8.1 to 8.13 of the Code of Ethics published by ICAN provide various guidelines to ensure independence in the performance of his professional work.

- 1.5. In the phases of a Professional Accountant's work, he is expected to be independent, but in particular in his work as auditor, independence has a special meaning and significance. Not only the client but also the stakeholders, prospective investors, bankers and government agencies rely upon the accounts of an enterprise when they are audited by a Professional Accountant. As statutory auditor of a limited company, for example, the Professional Accountant would cease to perform any useful function if the persons who rely upon the accounts of the Company do not have any faith in the independence and integrity of the Professional Accountant. In such cases he is expected to be objective in his approach, fearless, and capable of expressing an honest opinion based upon the performance of work such as his training and experience enables him to do so.
- 1.6. The objective of an audit of financial statements, prepared within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements. The auditor's opinion helps determination of the true and fair view of the financial position and operating results of an enterprise. The user, however, should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise.
- 1.7. The idea of independence is enshrined in the minds of Professional Accountants in the performance of their duties. It has to be applied in their day – to – day work and their success is dependent entirely upon their integrity, competence and independence of approach.
- 1.8. Dependent as it is on the state of mind and character of a person, independence, is a very subjective matter. One person might be independent in a particular set of circumstances, while another person might feel he is not independent in similar circumstances. It is therefore the duty of every Professional Accountant to determine for himself whether or not he can act independently in the given circumstances of a case and quite apart from legal rules, in no case to place himself in a position which would compromise his independence.
- 1.9. The Professional Accountant should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity. This is not self evident in the exercise of the reporting function but also applies to all other professional work. In determining whether a member in practice is or is not seen to be free of any interest which is

incompatible with objectivity, the criterion should be whether a reasonable person, having knowledge of relevant facts and taking into account the conduct of the member and the member's behaviour under the circumstances, could conclude that the member has placed himself in a position where his objectivity would or could be impaired.

1.10. While performing audit functions for maintaining quality control, policies to be adopted by an auditor shall ordinarily incorporate the following:

- (a) **Professional Requirements:**
Personnel in the firm are to adhere to the principles of independence, Integrity, Objectivity, Confidentiality and Professional Behaviours.
- (b) **Skills and Competence:**
The firm is to be staffed by personnel who have attained and maintained the Technical Standards and Professional Competence required to enable them to fulfill their responsibilities with Due Care.
- (c) **Assignment:**
Audit work is to be assigned to personnel who have the degree of technical training and proficiency required in the circumstances.
- (d) **Delegation:**
There is to be sufficient direction, supervision and review of work at all levels to provide reasonable assurance that the work performed meets appropriate standards of quality.
- (e) **Consultation:**
Whenever necessary, consultation within or outside the firm is to occur with those who have appropriate expertise.
- (f) **Acceptance and Retention of Clients:**
An evaluation of prospective clients and a review, on an ongoing basis, of existing clients is to be conducted. In making a decision to accept or retain a client, the firm's independence and ability to serve the client properly are to be considered.
- (g) **Monitoring:**

The continued adequacy and operational effectiveness of quality control policies and procedures is to be monitored.

1.11. A member not in practice has a duty to be objective in carrying out his or her professional work whether or not the appearance of professional independence is attainable. Thus a member performing professional work must recognize the problems created by personal relationships or financial involvement, which by reason of their nature or degree might threaten his independence.

- 1.12. Standing alone, the word "Independence" may lead observers to suppose that a person exercising professional judgement ought to be free from all economic, financial and other relationships. This is impossible, as every member of society has relationships with others. Therefore, the significance of economic, financial and other relationships should also be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.
- 1.13. Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist, requiring the application of different safeguards. A conceptual framework requires professional accountants to identify, evaluate and address threats to independence, rather than merely comply with a set of specific rules in the public interest.
- 1.14 This Statement is based on a conceptual approach that takes into account threats to independence, accepted safeguards and the public interest. Under this approach, firms and members of assurance teams have an obligation to identify and evaluate circumstances and relationships that create threats to independence and to take appropriate action to eliminate these threats or to reduce them to an acceptable level by the application of safeguards. In addition to identifying and evaluating relationships between the firm, network firms, members of the assurance team and the assurance client, consideration should be given to whether relationships between individuals who are outside the assurance team, and the assurance client, create threats to independence.
- 1.15 This Statement provides a framework of principles that members of assurance teams, firms and, where relevant, network firms should use to identify threats to independence, evaluate the significance of those threats, and, if the threats are other than clearly insignificant, identify and apply safeguards to eliminate the threats or reduce them to an acceptable level, such that independence of mind and independence in appearance are not compromised.
- 1.16 The nature of the threats to independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level differ depending on the characteristics of the individual engagement and the purpose, subject matter and intended users of the report. A firm should, therefore, evaluate the relevant circumstances, the nature of the assurance engagement and the threats to independence in deciding whether it is appropriate to accept or continue an engagement, as well as the nature of the safeguards required and whether a particular individual should be a member of the assurance team.
- 1.17 In the case of an assurance report to an assurance client expressly restricted for use by identified users, the users of the report are considered to be knowledgeable as to the purpose, subject matter and limitations of the report through their participation in establishing the nature and scope of the firm's instructions to deliver the services, including the criteria by which the subject matter are to be evaluated. This knowledge

and enhanced ability of the firm to communicate about safeguards with all users of the report increase the effectiveness of safeguards to independence in appearance. These circumstances may be taken into account by the firm in evaluating the threats to independence and considering the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level. At a minimum, it will be necessary to apply the provision of this Statement in evaluating the independence of members of the assurance team and their immediate and close family. Further, if the firm had a material financial interest, whether direct or indirect, in the assurance client, the self-interest threat created would be so significant that no safeguard could reduce the threat to an acceptable level. Limited consideration of any threats created by network firm interests and relationships may be sufficient.

1.18 Accordingly:

- for assurance engagements provided to an audit client, the members of the assurance team, the firm and the network firms are required to be independent of the client;
- for assurance engagements provided to clients that are not audit clients, when the report is not expressly restricted for use by identified users, the members of the assurance team and the firm are required to be independent of the client; and
- for assurance engagements provided to clients that are not audit clients, when the assurance report is expressly restricted for use by identified users, the members of the assurance team are required to be independent of the client. In addition, the firm should not have a material direct or indirect financial interest in the client.

1.19 This Statement provides a framework, built on principles, for identifying, evaluating and responding to threats to independence. The framework establishes principles that members of assurance teams, firms and network firms should use to identify threats to independence, evaluate the significance of those threats, and, if the threats are other than clearly insignificant, identify and apply safeguards to eliminate the threats or reduce them to an acceptable level. Judgement is needed to determine which safeguards are to be applied. Some safeguards may eliminate the threat while others may reduce the threat to an acceptable level. This Statement requires members of assurance teams, firms and network firms to apply the principles to the particular circumstances under consideration so as to ensure that the outcome achieves the substance of the objectives to which the principles are directed. The examples presented are intended to illustrate the application of the principles in this Statement and are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances that may create threats to independence. Consequently, it is not sufficient for a member of an assurance team, a firm or a network firm merely to comply with the examples presented, rather they should apply the principles in this Statement to the particular circumstances they face.

2. ASSURANCE ENGAGEMENTS AND AUDIT ENGAGEMENTS

- 2.1 In the case of an assurance engagement it is in the public interest and, therefore, required by the Code of Ethics, that members of assurance teams, firms and, when applicable, network firms be independent of assurance clients as independence is a necessary condition to maintain objectivity when performing assurance engagement.
- 2.2 When performing audit engagements, members should comply with the requirements of the Ethical Standards for Auditors issued by the ICAN. Before undertaking other assurance engagements for audit clients, members should consider the impact of the proposed engagement on the integrity and independence of the audit, by reference to the ICAN's Ethical Standards for Auditors.
- 2.3 Assurance engagements are intended to enhance the credibility of information about a subject matter by evaluating whether the subject matter conforms in all material respects with suitable criteria. For the purpose of the remainder of this Statement an assurance client includes an audit client in respect of which a non- audit assurance engagement is being performed
- 2.4. Whether a particular engagement is an assurance engagement will depend upon whether it exhibits all the following elements:
- a three party relationship involving:
 - (i) a member;
 - (ii) a responsible party; and
 - (iii) an intended user;
 - a subject matter;
 - suitable criteria;
 - an engagement process; and
 - a conclusion.
- 2.5. The member provides assurance to the intended user about subject matter that is the responsibility of another party. The responsible party and the intended user will often be from separate organisations but need not be. A responsible party and an intended user may both be within the same organisation. For example, a governing body may seek assurance about information provided by a component of that organisation. The relationship between the responsible party and the intended user needs to be viewed within the context of a specific engagement.

- 2.6. There is a broad range of engagements to provide a high or moderate level of assurance. Such engagements may include:
- engagements to report on a broad range of subject matters covering financial and non-financial information;
 - attest and direct reporting engagements;
 - engagements to report internally and externally; and
 - engagement in the private and public sector.
- 2.7. The subject matter of an assurance engagement may take many forms, such as the following:
- data (for example, historical or prospective financial information, statistical information, performance indicators);
 - system and processes (for example, internal controls); or
 - behaviour (for example, corporate governance, compliance with regulation, human resource practices).
- 2.8. The International Framework for Assurance Engagements (the Assurance Framework) issued by the International Auditing and Assurance Standards Board describes the elements and objectives of an assurance engagement, and identifies engagements to which International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs) and International Standards on Assurance Engagements (ISAEs) apply. For a description of the elements and objectives of an assurance engagement reference should be made to the Assurance Framework.
- 2.9. As further explained in the Assurance Framework, in an assurance engagement the professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.
- 2.10 The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. The term "subject matter information" is used to mean the outcome of the evaluation or measurement of subject matter. For example:
- The recognition, measurement, presentation and disclosure represented in the financial statements (subject matter information) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure, such as International Financial Reporting Standards, (criteria) to an entity's financial position, financial performance and cash flows (subject matter).

- An assertion about the effectiveness of internal control (subject matter information) results from applying a framework for evaluating the effectiveness of internal control, such as COSO or CoCo, (criteria) to internal control, a process (subject matter).
- 2.11. Assurance engagements may be assertion-based or direct reporting. In either case they involve three separate parties: a public accountant in public practice, a responsible party and intended users.
- 2.12. In an assertion-based assurance engagement, which includes a financial statement audit engagement, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users.
- 2.13. In a direct reporting assurance engagement the professional accountant in public practice either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report.

Assertion-based Assurance Engagements

Financial Statement Audit Engagements

- 2.14. Financial statement audit engagements are relevant to a wide range of potential users; consequently, in addition to independence of mind, independence in appearance is of particular significance. Accordingly, for financial statement audit clients, the members of the assurance team, the firm and network firms are required to be independent of the financial statement audit client. Such independence requirements include prohibitions regarding certain relationships between members of the assurance team and directors, officers and employees of the client in a position to exert direct and significant influence over the subject matter information (the financial statements). Also, consideration should be given to whether threats to independence are created by relationships with employees of the client in a position to exert direct and significant influence over the subject matter (the financial position, financial performance and cash flows).

Other Assertion-based Assurance Engagements

- 2.15. In an assertion-based assurance engagement where the client is not a financial statement audit client, the members of the assurance team and the firm are required to be independent of the assurance client (the responsible party, which is responsible for the subject matter information and may be responsible for the subject matter). Such independence requirements include prohibitions regarding certain relationships between members of the assurance team and directors, officers and employees of the client in a position to exert direct and significant influence over the subject matter information. Also, consideration should be given to whether threats to independence are created by

relationships with employees of the client in a position to exert direct and significant influence over the subject matter of the engagement. Consideration should also be given to any threats that the firm has reason to believe may be created by network firm interests and relationships.

- 2.16. In the majority of assertion-based assurance engagements, that are not financial statement audit engagements, the responsible party is responsible for the subject matter information and the subject matter. However, in some engagements the responsible party may not be responsible for the subject matter. For example, when a professional accountant in public practice is engaged to perform an assurance engagement regarding a report that an environmental consultant has prepared about a company's sustainability practices, or distribution to intended users, the environmental consultant is the responsible party for the subject matter information but the company is responsible for the subject matter (the sustainability practices).
- 2.17. In those assertion-based assurance engagements that are not financial statement audit engagements, where the responsible party is responsible for the subject matter information but not the subject matter, the members of the assurance team and the firm are required to be independent of the party responsible for the subject matter information (the assurance client). In addition, consideration should be given to any threats the firm has reason to believe may be created by interests and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.

Restricted Use Reports

- 2.18. In the case of an assurance report in respect of a non-financial statement audit client expressly restricted for use by identified users, the users of the report are considered to be knowledgeable as to the purpose, subject matter information and limitations of the report through their participation in establishing the nature and scope of the firm's instructions to deliver the services, including the criteria against which the subject matter are to be evaluated or measured. This knowledge and the enhanced ability of the firm to communicate about safeguards with all users of the report increase the effectiveness of safeguards to independence in appearance. These circumstances may be taken into account by the firm in evaluating the threats to independence and considering the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level. At a minimum, it will be necessary to apply the provisions of this section in evaluating the independence of members of the assurance team and their immediate and close family. Further, if the firm had a material financial interest, whether direct or indirect, in the assurance client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Limited consideration of any threats created by network firm interests and relationships may be sufficient.

Multiple Responsible Parties

- 2.19. In some assurance engagements, whether assertion-based or direct reporting, that are not financial statement audit engagements, there might be several responsible parties. In such

engagements, in determining whether it is necessary to apply the provisions in this section to each responsible party, the firm may take into account whether an interest or relationship between the firm, or a member of the assurance team, and a particular responsible party would create a threat to independence that is other than clearly insignificant in the context of the subject matter information. This will take into account factors such as:

- The materiality of the subject matter information (or the subject matter) for which the particular responsible party is responsible; and
- The degree of public interest associated with the engagement.

If the firm determines that the threat to independence created by any such interest or relationship with a particular responsible party would be clearly insignificant it may not be necessary to apply all of the provisions of this section to that responsible party.

Other Considerations

- 2.20. The threats and safeguards identified in this section are generally discussed in the context of interests or relationships between the firm, network firms, members of the assurance team and the assurance client. In the case of a financial statement audit client that is a listed entity, the firm and any network firms are required to consider the interests and relationships that involve that client's related entities. Ideally those entities and the interests and relationships should be identified in advance. For all other assurance clients, when the assurance team has reason to believe that a related entity of such an assurance client is relevant to the evaluation of the firm's independence of the client, the assurance team should consider that related entity when evaluating independence and applying appropriate safeguards.
- 2.21. The evaluation of threats to independence and subsequent action should be supported by evidence obtained before accepting the engagement and while it is being performed. The obligation to make such an evaluation and take action arises when a firm, a network firm or a member of the assurance team knows, or could reasonably be expected to know, of circumstances or relationships that might compromise independence. There may be occasions when the firm, a network firm or an individual inadvertently violates this section. If such an inadvertent violation occurs, it would generally not compromise independence with respect to an assurance client provided the firm has appropriate quality control policies and procedures in place to promote independence and, once discovered, the violation is corrected promptly and any necessary safeguards are applied.
- 2.22. Throughout this section, reference is made to significant and clearly insignificant threats in the evaluation of independence. In considering the significance of any particular matter, qualitative as well as quantitative factors should be taken into account. A matter should be considered clearly insignificant only if it is deemed to be both trivial and inconsequential.

3. **FUNDAMENTAL PRINCIPLES**

To maintain Independence, the professional accountant must observe the following fundamental principles while carrying out their professional work.

Fundamental principles 1 – "Integrity"

A member should behave with integrity in all professional and business relationships. Integrity implies not merely honesty but fair dealing and truthfulness. A member's advice and work must be uncorrupted by self-interest and not be influenced by the interests of other parties.

Fundamental principle 2 – " Objectivity"

A member should strive for objectivity in all professional and business judgements. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other.

Fundamental principle 3 – " Competence"

A member should undertake professional work only where he has the necessary competence required to carry out that work, supplemented where necessary by appropriate assistance or consultation.

Fundamental Principle 4 – " Performance"

A member should carry out his professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of him as a member.

Fundamental principle 5 – "Courtesy"

A member should conduct himself with courtesy and consideration towards all with whom he comes into contact during the course of performing his work.

The above fundamental principles are also given in Paragraph 8.1 to 8.13 of the Code of Ethics issued by ICAN.

4. **OBJECTIVE & STRUCTURE OF THE GUIDELINES**

4.1. The objective of this section is to assist firms and members of assurance teams in:

- (a) Identifying threats to independence;
- (b) Evaluating whether these threats are clearly insignificant; and
- (c) In cases when the threats are not clearly insignificant, identifying and applying appropriate safeguards to eliminate or reduce the threats to an acceptable level.

Consideration should always be given to what a reasonable and informed third party having knowledge of all relevant information, including safeguards applied, would reasonably conclude to be unacceptable. In situations when no safeguards are available to reduce the threat to an acceptable level, the only possible actions are to eliminate the

- activities or interest creating the threat, or to refuse to accept or continue the assurance engagement.
- 4.2 This section concludes with some examples of how this conceptual approach to independence is to be applied to specific circumstances and relationships. The examples discuss threats to independence that may be created by specific circumstances and relationships (Appendix A and B). Professional judgment is used to determine the appropriate safeguards to eliminate threats to independence or to reduce them to an acceptable level. In certain examples, the threats to independence are so significant the only possible actions are to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement. In other examples, the threat can be eliminated or reduced to an acceptable level by the application of safeguards. The examples are not intended to be all-inclusive.
 - 4.3 When threats to independence that are not clearly insignificant are identified, and the firm decides to accept or continue the assurance engagement, the decision should be documented. The documentation should include a description of the threats identified and the safeguards applied to eliminate or reduce the threats to an acceptable level.
 - 4.4 The evaluation of the significance of any threats to independence and the safeguards necessary to reduce any threats to an acceptable level, takes into account the public interest. Certain entities may be of significant public interest because, as a result of their business, their size or their corporate status they have a wide range of stakeholders. Examples of such entities may include listed companies, credit institutions, insurance companies, and pension funds. Because of the strong public interest in the financial statements of listed entities, certain paragraphs in this section deal with additional matters that are relevant to the financial statement audit of listed entities. Consideration should be given to the application of the framework in relation to the financial statement audit of listed entities to other financial statement audit clients that may be of significant public interest.
 - 4.5. The examples in the following sections are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances experienced by a professional accountant in public practice that may create threats to compliance with the principles. Consequently, it is not sufficient for a professional accountant in public practice merely to comply with the examples presented; rather, the framework should be applied to the particular circumstances faced.
 - 4.6. A professional accountant in public practice should not engage in any business, occupation or activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the rendering of professional services.

Threats to Independence

4.7. Compliance with the fundamental principles and independence may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:

- (a) **Self-interest;**
- (b) **Self-review;**
- (c) **Advocacy;**
- (d) **Familiarity; and**
- (e) **Intimidation.**

The nature and significance of the threats may differ depending on whether they arise in relation to the provision of services to a financial statement audit client, a non-financial statement audit assurance client or a non-assurance client.

4.8. Examples of circumstances that may create **self-interest** threats for a professional accountant in public practice include, but are not limited to:

- A financial interest in a client or jointly holding a financial interest with a client.
- Undue dependence on total fees from a client.
- Having a close business relationship with a client.
- Concern about the possibility of losing a client.
- Potential employment with a client.
- Contingent fees relating to an assurance engagement.
- A loan or guarantee to or from an assurance client or any of its directors or officers.

4.9. **"Self-Review Threat" occurs when**

- 1) any product or judgement of a previous assurance or non-assurance engagement needs to be re-evaluated in reaching conclusions on the current assurance engagement or
- 2) when a member of the assurance team was previously in a position to exert direct and significant influence over the subject matter of the assurance engagement.

Example of circumstances that may create this threat include, but are not limited to:

- a member of the assurance team being, or having recently been, a director or officer of the assurance client;
- a member of the assurance team being, or having recently been, an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement;
- the firm had performed services for an assurance client that directly affect the subject matter of the assurance engagement; and
- the firm has prepared original data used to generate financial statements or other records that are the subject matter of the assurance engagement.

4.10. Examples of circumstances that may create self-review threats include, but are not limited to:

- The discovery of a significant error during a re-evaluation of the work of the professional accountant in public practice.
- Reporting on the operation of financial systems after being involved in their design or implementation.
- Having prepared the original data used to generate financial records that are the subject matter of the engagement.
- A member of the assurance team being, or having recently been, a director or officer of that client.
- A member of the assurance team being, or having recently been, employed by the client in a position to exert direct and significant influence over the subject matter of the assurance engagement.
- Performing a service for a client that directly affects the subject matter of the assurance engagement.

4.11. An "**Advocacy Threat**" occurs when a firm, or a member of the assurance team, promotes, or may be perceived to promote, an assurance client's position or opinion to the point that objectivity may, or may be perceived to be, compromised. Such may be the case if a firm or a member of the assurance team were to subordinate their judgement to that of the client.

Examples of circumstances that may create this threat include, but are not limited to:

- dealing in, or marketing, shares or other securities is an assurance client; and

- acting as an advocate on behalf of an assurance client in litigation or in resolving disputes with third parties.

4.12. A "**Familiarity Threat**" occurs when, by virtue of a close relationship with an assurance client, its directors, officers or employees, a firm or a member of the assurance team becomes too sympathetic to the client's interests.

Examples or circumstances that may create this threat include, but are not limited to:

- a member of the assurance team having an immediate family member or close family member who is a director or officer of the assurance client;
- a member of the assurance team having an immediate family member or close family member who, as an employee of the assurance client, is in a position to exert direct and significant influence over the subject matter of the assurance engagement;
- a former partner of the firm being a director, officer of the assurance client or an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement;
- long association of a senior member of the assurance team with the assurance client; and
- acceptance of gifts or hospitality, unless the value is clearly insignificant, from the assurance client, its directors officers or employees.

4.13. "Intimidation Threat" occurs when a members of the assurance team may be deterred from acting objectively and exercising professional skepticism by threats, actual or perceived, from the directors, officers or employees of an assurance client, or from within the firm.

Examples of circumstances that may create **intimidation threats** include, but are not limited to:

- Being threatened with dismissal or replacement in relation to a client engagement with the application of on accounting principles.
- Being threatened with litigation.
- Being pressured to reduce inappropriately the extent of work performed in order to reduce fees.

4.14. A professional accountant in public practice may also find that specific circumstances give rise to unique threats to compliance with one or more of the fundamental principles. Such unique threats obviously cannot be categorized, in either professional or business relationships, a professional accountant in public practice should always be on the alert for such circumstances and threats.

The firm and members of the assurance team have a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats or reduce them to an acceptable level.

Safeguards

- 4.15. Safeguards that may eliminate or reduce threats to an acceptable level fall into three broad categories:
- (a) Safeguards created by the profession, legislation or regulation; and
 - (b) Safeguards within the assurance client; and
 - (c) Safeguards within the firm's own systems and procedures.
- 4.16 Safeguards created by the profession, legislation or regulation include the following:
- educational, training and experience requirements for entry into the profession;
 - continuing education requirements;
 - professional standards and associated monitoring and disciplinary processes;
 - external review of a firm's quality control system; and
 - legislation governing the independence requirements of the firm.
- 4.17. Within the assurance client, the relevant safeguards will vary depending on the circumstances. Work environment safeguards comprise firm-wide safeguards and engagement specific safeguards. A professional accountant in public practice should exercise judgment to determine how to best deal with an identified threat. In exercising this judgment a professional accountant in public practice should consider what a reasonable and informed third party, having knowledge of all relevant information, including the significance of the threat and the safeguards applied, would reasonably conclude to be acceptable. This consideration will be affected by matters such as the significance of the threat, the nature of the engagement and the structure of the firm.
- 4.18. Depending on the nature of the engagement, a professional accountant in public practice may also be able to rely on safeguards that the client has implemented. However it is not possible to rely solely on such safeguards to reduce threats to an acceptable level.
- 4.19. Safeguards within the client's systems and procedures may include:
- When the assurance client's management appoints the firm, persons other than management ratify or approve the appointment.

- The assurance client has competent employees to make managerial decisions.
- policies and procedures that emphasize the assurance client's commitment to fair reporting;
- internal procedures that ensure objective choices in commissioning other assurance and non-assurance engagements; and
- a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

4.20. Safeguards within the firm's own systems and procedures may include firm-wide safeguards such as the following:

- leadership that stresses the importance of independence and the expectation that members of assurance teams will act in the public interest;
- policies and procedures to implement and monitor quality control of assurance engagements;
- documented independence policies regarding the identification of threats to independence, the evaluation of the significance of these threats and the identification and application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level;
- internal policies and procedures to monitor compliance with firm policies and procedures as they relate to independence;
- policies and procedures that will enable the identification of interest or relationships between the firm or members of the assurance team and assurance clients;
- policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single assurance client;
- using different partners and 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 the assurance team from influencing the outcome of the assurance engagement;
- timely communication of a firm's policies and procedures, and any changes thereto, to all partners and professional staff, including appropriate training and education thereon;
- designating a member of senior management as responsible for overseeing the adequate functioning of the safeguarding system;

- consultation with Partners separate from the engagement and client relationship, such as the 'ethics partner' required by the Ethical Standards for Auditors issued by the Auditors Practices Board, technical or risk management or compliance partners;
- means of advising partners and professional staff of those assurance clients and related entities from which they must be independent;
- a disciplinary mechanism to promote compliance with policies and procedures: and
- policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them; this includes informing staff of the procedures open to them.

4.21. Safeguards within the firm's own systems and procedures may include engagement specific safeguards such as the following:

- involving an additional member to review the work done or otherwise advise as necessary. This individual could be someone from outside the firm or network firm, or someone within the firm or network firm who was not otherwise associated with the assurance team;
- consulting a third party about potential issues, such as a committee of independent directors, a professional regulatory body or another professional;
- rotation of senior personnel;
- discussing independence issues identified with the client's audit committee or others charged with governance;
- disclosing to the audit committee or others charged with governance, the nature of services provided and extent of fees charged;
- policies and procedures to ensure members of the assurance team do not make, or assume responsibility for, management decisions for the assurance client;
- involving another firm to perform or re-perform part of the assurance engagement;
- involving another firm to re-perform the non-assurance service to the extent necessary to enable it to take responsibility for that service; and
- removing an individual from the assurance team for a particular engagement (by prohibition or self-exclusion from direct participation by those in a position to exert influence), when that individual's financial interests or relationships create a threat to independence.

- 4.22. When the safeguards available, such as those described above, are insufficient to eliminate the threats to independence or to reduce them to an acceptable level, or when a firm chooses not to eliminate the activities or interests creating the threat, the only course of action available will be the refusal to perform, or withdrawal from, the assurance engagement.
- 4.23. A professional accountant in public practice should consider when providing any professional service whether there are threats to compliance with the fundamental principle of objectivity resulting from having interests in, or relationships with, a client or directors, officers or employees. For example, a familiarity threat to objectivity may be created from a family or close personal or business relationship.
- 4.24. 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 in public practice to express a conclusion, and be seen to express a conclusion, without bias, conflict of interest or undue influence of others. Appendix to this guidance with provides specific guidance on independence requirements for professional accountants in public practice when performing an assurance engagement.
- 4.25. The existence of threats to objectivity when providing any professional service will depend upon the particular circumstances of the engagement and the nature of the work that the professional accountant in public practice is performing.
- 4.26. A professional accountant in public practice should evaluate the significance of identified threats and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include:
- Withdrawing from the engagement team.
 - Supervisory procedures.
 - Terminating the financial or business relationship giving rise to the threat.
 - Discussing the issue with higher levels of management within the firm.
 - Discussing the issue with those charged with governance of the client.

Appointment and Disqualification of Auditors

- 4.27. The principle of professional behavior imposes an obligation on professional accountants to comply with relevant laws and regulations and avoid any action that may bring discredit to the profession. This includes actions which a reasonable and informed third party, having knowledge of all relevant information, would conclude negatively affects the good reputation of the profession.

In view of the above concept and also with a view to maintain independence both in mind and appearance, the professional accountant must comply with the prevailing provisions of laws and regulations.

4.27.1 Provisions of Company Ordinance, 2062:

4.27.1.1 Appointment of auditors: (Sections 74, 77, 164 and 165)

- Audit committee of a listed public company having paid up capital of not less than Rs.3 Crores and of the government owned companies shall recommend the names, terms and remuneration of the auditors to the General Meeting.
- The appointment of the auditor and fixing the terms and remuneration shall be made through a separate agenda and by a resolution under Sec.111 proposed to the General Meeting.

4.27.1.2 Disqualification of auditor: (Section 112)

- (1) The following person, or the firm in which he is a partner or a company, shall not be appointed as auditor, or if already appointed shall not remain in office in that capacity:
 - (a) any director or advisor or any person among the management group of the company, or any employee or worker of the company,
 - any partner of any such person,
 - any employee of any of such partners,
 - any close relative of any of such persons, or
 - any employee of any of such persons.
 - (b) Any debtor of the company.
 - (c) Any person who has yet to complete five years after being punished on an offence pertaining to audit.
 - (d) Any person who is insolvent.
 - (e) Any shareholder of the company or any of the close relatives of any person holding one percent or more of the paid-up capital of the company.
 - (f) Any person who has yet to complete five years after being punished for corruption, cheating or criminal offence involving moral turpitude.

- (g) The same auditor or his current or former partner or employee shall not be appointed to audit the accounts of a public company for more than three consecutive terms.
Provided that this restriction shall not be applicable in respect to any partner of the auditor who has quit the partnership three years before, or any employee of the auditor who has quit his service three years before.
- (h) In the case of a public company, any person working in any governmental or non-governmental body or any other company on a full or part time basis,
- any of his partners,
 - any of the persons working as employees of such partners, or
 - any person who is authorised to sign any document or report on behalf of the company.
- (i) Any company or corporate body with limited liability.
- (j)
- Any person having any interest in any transaction with the company, or any of his close relatives, or
 - Any director, office-bearer or basic shareholder of any other company having any other interest in any transaction with the company.
- (2) The auditor must, prior to his appointment, inform the company in writing that he is not disqualified.
- (3) In case any auditor becomes disqualified for auditing the accounts of the company before the expiry of his term, or in case a situation emerges in which he can no longer be appointed or continue as the auditor of the company, he must immediately stop the auditing and inform thereof in writing to the company.
- (4) Any audit by any person who is appointed in contrary to the above provision shall not be valid.

4.28. Ordinance Relating to Banks and Financial Institutions, 2062

4.28.1 Appointment of auditor (Section 60):

- The General Meeting shall appoint the auditor from among the panel of the auditors of Nepal Rashtra Bank

- However, the General Meeting cannot appoint the same auditor for more than three consecutive terms.
- The General Meeting shall appoint chartered accountants for A, B and C class Banks and Financial Institutions and chartered accountant or registered auditor for D class institutions.
- Any auditor not discharging professional responsibilities can be removed by Nepal Rashtira Bank from the panel of auditors.

4.28.2 **Disqualification of Auditors (Section 61):**

- (a) Director of the Banks and Financial Institutions or his family member.
- (b) Employee of the Bank and Financial Institution.
- (c) Any partner of the director or of the employee of the Bank and Financial Institution.
- (d) Debtor of the Banks and Financial Institutions.
- (e) Any person who has yet to complete five years after being punished on an offence pertaining to audit.
- (f) Any person who is insolvent.
- (g) Any person, firm, company or entity holding one percent or more of the shares in the Bank or Financial Institution.
- (h) Any person who has yet to complete five years after being punished for a criminal offence involving moral turpitude by a court of law.
- (i) Any person punished for an offence of fraud or corruption by a court of law.

4.29 **Ordinance relating to Securities Transactions, 2062 (Sections 80 and 81)**

- (1) The company or institution who are security dealers shall appoint the auditor from among the auditors listed by the Securities Board.
- (2) Director, shareholder, officer, employee or partner of such persons of a corporate body or company dealing in securities is disqualified for appointment as auditor of such securities transaction company or corporate body.
- (3) Company dealing in securities transaction shall inform the Securities Board, the name and address of the auditor, within 7 days of his appointment.

- (4) Company dealing in securities transaction shall, if it removes the auditor or such auditors vacates office by resignation, inform the Securities Board of the same within 7 days thereof.

4.30 The Cooperative Act, 2048 (Section 37):

- (i) The auditor of the Cooperatives shall be appointed at the General Meeting by fixing the remuneration after taking approval from the Registrar.
- (ii) The auditor so appointed would not be eligible for appointment as an auditor for a period of more than three consecutive terms.

5. EXAMPLES:

- 5.1 Appendixes A and B provides examples of safeguards that may be appropriate to address threats to compliance with the fundamental principles and also provides examples of situations where safeguards are not available to address the threats and consequently the activity or relationship creating the threats should be avoided. Appendix A applies to professional accountants in public practice. Appendix B applies to professional accountants in business. Professional accountants in public practice may also find the guidance in Appendix B relevant to their particular circumstances.
- 5.2. Audit committees can have an important corporate governance role when they are independent of client management and can assist the Board of Directors in satisfying themselves that a firm is independent in carrying out its audit role. There should be regular communications between the firm and the audit committee (or other governance body if there is no audit committee) of listed entities regarding relationships and other matters that might, in the firm's opinion, reasonably be thought to bear on independence.
- 5.3. Firms should establish policies and procedures relating to independence communications with audit committees, or others charged with governance of the client. In the case of the financial statement audit of listed entities, the firm should communicate orally and in writing at least annually, all relationships and other matters between the firm, network firms and the financial statement audit client that in the firm's professional judgment may reasonably be thought to bear on independence. Matters to be communicated will vary in each circumstance and should be decided by the firm, but should generally address the relevant matters set out in this section.

Engagement Period

- 5.4. The members of the assurance team and the firm should be independent of the assurance client during the period of the assurance engagement. The period of the engagement starts when the assurance team begins to perform assurance services and ends when the assurance report is issued, except when the assurance engagement is of a recurring nature. If the assurance engagement is expected to recur, the period of the assurance

engagement ends with the notification by either party that the professional relationship has terminated or the issuance of the final assurance report, whichever is later.

- 5.5. When an entity becomes an assurance client, the firm should consider whether any prior financial or business relationships or previous services may create threats to independence.
- 5.6. In the case of a financial statement audit engagement, the engagement period includes the period covered by the financial statements reported on by the firm. When an entity becomes a financial statement audit client during or after the period covered by the financial statements that the firm will report on, the firm should consider whether any threats to independence may be created by:
 - Financial or business relationships with the audit client during or after the period covered by the financial statements, but prior to the acceptance of the financial statement audit engagement; or
 - Previous services provided to the audit client.

Similarly, in the case of an assurance engagement that is not a financial statement audit engagement, the firm should consider whether any financial or business relationships or previous services may create threats to independence.

- 5.7. If a non-assurance service was provided to the financial statement audit client during or after the period covered by the financial statements but before the commencement of professional services in connection with the financial statement audit and the service would be prohibited during the period of the audit engagement, consideration should be given to the threats to independence, if any, arising from the service. If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards may include:
 - Discussing independence issues related to the provision of the non-assurance service with those charged with governance of the client, such as the audit committee;
 - Obtaining the client's acknowledgement of responsibility for the results of the non-assurance service;
 - Precluding personnel who provided the non-assurance service from participating in the financial statement audit engagement; and
 - Engaging another firm to review 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.

- 5.8. A non-assurance service provided to a non-listed financial statement audit client will not impair the firm's independence when the client becomes a listed entity provided:
- (a) The previous non-assurance service was permissible under this section for non-listed financial statement audit clients;
 - (b) The service will be terminated within a reasonable period of time of the client becoming a listed entity, if they are impermissible under this section for financial statement audit clients that are listed entities; and
 - (c) The firm has implemented appropriate safeguards to eliminate any threats to independence arising from the previous service or reduce them to an acceptable level.

APPENDIX A: APPLICATION OF FRAMEWORK TO SPECIFIC SITUATIONS FOR PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

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INTRODUCTION

- A.100 The following examples describe specific circumstances and relationships that may create threats to independence. The examples describe the potential threats created and the safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level in each circumstance. The examples are not all inclusive. In practice, the firm, network firms and the members of the assurance team will be required to assess the implications of similar, but different, circumstances and relationships and to determine whether safeguards, including the safeguards in paragraphs **4.15 through 4.22** can be applied to satisfactorily address the threats to independence.
- A.101 Some of the examples deal with financial statement audit clients while others deal with assurance engagements for clients that are not financial statement audit clients. The examples illustrate how safeguards should be applied to fulfill the requirement for the members of the assurance team, the firm and network firms to be independent of a financial statement audit client, and for the members of the assurance team and the firm to be independent of an assurance client that is not a financial statement audit client. The examples do not include assurance reports to a non-financial statement audit client expressly restricted for use by identified users. As stated in paragraph A.19 for such engagements, members of the assurance team and their immediate and close family are required to be independent of the assurance client. Further, the firm should not have a material financial interest, direct or indirect, in the assurance client.

FINANCIAL INTERESTS

- A.102 The examples illustrate how the framework applies to financial statement audit clients and other assurance clients. The examples should be read in conjunction with paragraphs 2.18 which explain that, in the majority of assurance engagements, there is one responsible party and that responsible party comprises the assurance client. However, in some assurance engagements there are two responsible parties. In such circumstances, consideration should be given to any threats the firm has reason to believe may be created by interests and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.
- A.103 An actual or impending financial interest in an assurance client may create a self-interest threat. In evaluating the significance of the threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, it is necessary to examine the nature of the financial interest. This includes an evaluation of the role of the person holding the financial interest, the materiality of the financial interest and the type of financial interest (direct or indirect).
- A.104 When evaluating the type of financial interest, consideration should be given to the fact that financial interests range from those where the individual has no control over the investment vehicle or the financial interest held (e.g., a mutual fund, unit trust or similar intermediary vehicle) to those where the individual has control over the financial interest (e.g., as a trustee) or is able to influence investment decisions. In evaluating the

significance of any threat to independence, it is important to consider the degree of control or influence that can be exercised over the intermediary, the financial interest held, or its investment strategy. When control exists, the financial interest should be considered direct. Conversely, when the holder of the financial interest has no ability to exercise such control the financial interest should be considered indirect.

PROVISIONS APPLICABLE TO ALL ASSURANCE CLIENTS

- A.105 If a member of the assurance team, or their immediate family member, has a direct financial interest, or a material indirect financial interest, in the assurance client, the self-interest threat created would be so significant the only safeguards available to eliminate the threat or reduce it to an acceptable level would be to:
- (a) Dispose of the direct financial interest prior to the individual becoming a member of the assurance team;
 - (b) Dispose of the indirect financial interest in total or dispose of a sufficient amount of it so that the remaining interest is no longer material prior to the individual becoming a member of the assurance team; or
 - (c) Remove the member of the assurance team from the assurance engagement.
- A.106 If a member of the assurance team, or their immediate family member receives, by way of, for example, an inheritance, gift or, as a result of a merger, a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat would be created. The following safeguards should be applied to eliminate the threat or reduce it to an acceptable level:
- (a) Disposing of the financial interest at the earliest practical date; or
 - (b) Removing the member of the assurance team from the assurance engagement.

During the period prior to disposal of the financial interest or the removal of the individual from the assurance team, consideration should be given to whether additional safeguards are necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Discussing the matter with those charged with governance, such as the audit committee; or
- Involving an additional professional accountant to review the work done, or otherwise advise as necessary.

- A.107 When a member of the assurance team knows that his or her close family member has a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat may be created. In evaluating the significance of any threat, consideration should be given to the nature of the relationship between the member of the assurance team and the close family member and the materiality of the financial interest. Once the significance of the threat has been evaluated, safeguards should be considered and applied as necessary. Such safeguards might include:

- The close family member disposing of all or a sufficient portion of the financial interest at the earliest practical date;
- Discussing the matter with those charged with governance, such as the audit committee;
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team with the close family relationship or otherwise advise as necessary; or
- Removing the individual from the assurance engagement.

A.108 When a firm or a member of the assurance team holds a direct financial interest or a material indirect financial interest in the assurance client as a trustee, a self-interest threat may be created by the possible influence of the trust over the assurance client. Accordingly, such an interest should only be held when:

- (a) The member of the assurance team, an immediate family member of the member of the assurance team, and the firm are not beneficiaries of the trust;
- (b) The interest held by the trust in the assurance client is not material to the trust;
- (c) The trust is not able to exercise significant influence over the assurance client; and
- (d) The member of the assurance team or the firm does not have significant influence over any investment decision involving a financial interest in the assurance client.

A.109 Consideration should be given to whether a self-interest threat may be created by the financial interests of individuals outside of the assurance team and their immediate and close family members. Such individuals would include:

- Partners, and their immediate family members, who are not members of the assurance team;
- Partners and managerial employees who provide non-assurance services to the assurance client; and
- Individuals who have a close personal relationship with a member of the assurance team. Whether the interests held by such individuals may create a self-interest threat will depend upon 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 assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Where appropriate, policies to restrict people from holding such interests;
- Discussing the matter with those charged with governance, such as the audit committee; or
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done or otherwise advise as necessary.

- A.110 An inadvertent violation of this section as it relates to a financial interest in an assurance client would not impair the independence of the firm, the network firm or a member of the assurance team when:
- (a) The firm, and the network firm, have established policies and procedures that require all professionals to report promptly to the firm any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;
 - (b) The firm, and the network firm, promptly notify the professional that the financial interest should be disposed of; and
 - (c) The disposal occurs at the earliest practical date after identification of the issue, or the professional is removed from the assurance team.
- A.111 When an inadvertent violation of this section relating to a financial interest in an assurance client has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or
 - Excluding the individual from any substantive decision-making concerning the assurance engagement.

PROVISIONS APPLICABLE TO FINANCIAL STATEMENT AUDIT CLIENTS

- A.112 If a firm, or a network firm, has a direct financial interest in a financial statement audit client of the firm the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.
- A.113 If a firm, or a network firm, has a material indirect financial interest in a financial statement audit client of the firm a self-interest threat is also created. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.
- A.114 If a firm, or a network firm, has a material financial interest in an entity that has a controlling interest in a financial statement audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the financial interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.
- A.115 If the retirement benefit plan of a firm, or network firm, has a financial interest in a financial statement audit client a self-interest threat may be created. Accordingly, the significance of any such threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

- A.116 If other partners, including partners who do not perform assurance engagements, or their immediate family, in the office* in which the engagement partner practices in connection with the financial statement audit hold a direct financial interest or a material indirect financial interest in that audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such partners or their immediate family should not hold any such financial interests in such an audit client.
- A.117 The office in which the engagement partner practices in connection with the financial statement audit is not necessarily the office to which that partner is assigned. Accordingly, when the engagement partner is located in a different office from that of the other members of the assurance team, judgment should be used to determine in which office the partner practices in connection with that audit.
- A.118 If other partners and managerial employees who provide non-assurance services to the financial statement audit client, except those whose involvement is clearly insignificant, or their immediate family, hold a direct financial interest or a material indirect financial interest in the audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such personnel or their immediate family should not hold any such financial interests in such an audit client.
- A.119 A financial interest in a financial statement audit client that is held by an immediate family member of
- (a) a partner located in the office in which the engagement partner practices in connection with the audit, or
 - (b) a partner or managerial employee who provides non-assurance services to the audit client is not considered to create an unacceptable threat provided it is received as a result of their employment rights (e.g., pension rights or share options) and, where necessary, appropriate safeguards are applied to reduce any threat to independence to an acceptable level.
- A.120 A self-interest threat may be created if the firm, or the network firm, or a member of the assurance team has an interest in an entity and a financial statement audit client, or a director, officer or controlling owner thereof also has an investment in that entity. Independence is not compromised with respect to the audit client if the respective interests of the firm, the network firm, or member of the assurance team, and the audit client, or director, officer or controlling owner thereof are both immaterial and the audit client cannot exercise significant influence over the entity. If an interest is material, to either the firm, the network firm or the audit client, and the audit client can exercise significant influence over the entity, no safeguards are available to reduce the threat to an acceptable level and the firm, or the network firm, should either dispose of the interest or decline the audit engagement. Any member of the assurance team with such a material interest should either:
- (a) Dispose of the interest;

- (b) Dispose of a sufficient amount of the interest so that the remaining interest is no longer material; or
- (c) Withdraw from the audit.

PROVISIONS APPLICABLE TO NON-FINANCIAL STATEMENT AUDIT ASSURANCE CLIENTS

- A.121 If a firm has a direct financial interest in an assurance client that is not a financial statement audit client the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.
- A.122 If a firm has a material indirect financial interest in an assurance client that is not a financial statement audit client a self-interest threat is also created. The only action appropriate to permit the firm to perform the engagement would be for the firm to either dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.
- A.123 If a firm has a material financial interest in an entity that has a controlling interest in an assurance client that is not a financial statement audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. The only action appropriate to permit the firm to perform the engagement would be for the firm either to dispose of the financial interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.
- A.124 When a restricted use report for an assurance engagement that is not a financial statement audit engagement is issued, exceptions to the provisions in paragraphs A.105 through A.109 and A.121 through A.123 are set out in 2.18.

LOANS AND GUARANTEES

- A.125 A loan, or a guarantee of a loan, to the firm from an assurance client that is a bank or a similar institution, would not create a threat to independence provided the loan, or guarantee, is made under normal lending procedures, terms and requirements and the loan is immaterial to both the firm and the assurance client. If the loan is material to the assurance client or the firm it may be possible, through the application of safeguards, to reduce the self-interest threat created to an acceptable level. Such safeguards might include involving an additional professional accountant from outside the firm, or network firm, to review the work performed.
- A.126 A loan, or a guarantee of a loan, from an assurance client that is a bank or a similar institution, to a member of the assurance team or their immediate family would not create a threat to independence provided the loan, or guarantee, is made under normal lending procedures, terms and requirements. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.

- A.127 Similarly, deposits made by, or brokerage accounts of, a firm or a member of the assurance team with an assurance client that is a bank, broker or similar institution would not create a threat to independence provided the deposit or account is held under normal commercial terms.
- A.128 If the firm, or a member of the assurance team, makes a loan to an assurance client, that is not a bank or similar institution, or guarantees such an assurance client's borrowing, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.
- A.129 Similarly, if the firm or a member of the assurance team accepts a loan from, or has borrowing guaranteed by, an assurance client that is not a bank or similar institution, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.
- A.130 The examples in paragraphs A.125 through A.129 relate to loans and guarantees between the firm and an assurance client. In the case of a financial statement audit engagement, the provisions should be applied to the firm, all network firms and the audit client.

CLOSE BUSINESS RELATIONSHIPS WITH ASSURANCE CLIENTS

- A.131 A close business relationship between a firm or a member of the assurance team and the assurance client or its management, or between the firm, a network firm and the assurance audit client, will involve a commercial or common financial interest and may create self-interest and intimidation threats. The following are examples of such relationships:
- Having a material financial interest in a joint venture with the assurance client or a controlling owner, director, officer or other individual who performs senior managerial functions for that client.
 - Arrangements to combine one or more services or products of the firm with one or more services or products of the assurance client and to market the package with reference to both parties.
 - Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the assurance client's products or services, or the assurance client acts as the distributor or marketer of the products or services of the firm.

In the case of a financial statement audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm, the network firm and the audit client, no safeguards could reduce the threat to an acceptable level. In the case of an assurance client that is not a financial statement audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm and the assurance client, no safeguards could reduce the threat to an acceptable level. Consequently, in both these circumstances the only possible courses of action are to:

- (a) Terminate the business relationship;
- (b) Reduce the magnitude of the relationship so that the financial interest is immaterial and the relationship is clearly insignificant; or
- (c) Refuse to perform the assurance engagement.

Unless any such financial interest is immaterial and the relationship is clearly insignificant to the member of the assurance team, the only appropriate safeguard would be to remove the individual from the assurance team.

A.132 In the case of a financial statement audit client, business relationships involving an interest held by the firm, a network firm or a member of the assurance team or their immediate family in a closely held entity when the audit client or a director or officer of the audit client, or any group thereof, also has an interest in that entity, do not create threats to independence provided:

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

A.133 The purchase of goods and services from an assurance client by the firm (or from a financial statement audit client by a network firm) or a member of the assurance team would not generally create a threat to independence providing the transaction is in the normal course of business and on an arm's length basis. However, such transactions may be of a nature or magnitude so as to create a self-interest threat. If the threat created is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Eliminating or reducing the magnitude of the transaction;
- Removing the individual from the assurance team; or
- Discussing the issue with those charged with governance, such as the audit committee.

FAMILY AND PERSONAL RELATIONSHIPS

A.134 Family and personal relationships between a member of the assurance team and a director, an officer or certain employees, depending on their role, of the assurance client, may create self-interest, familiarity or intimidation threats. It is impracticable to attempt to describe in detail the significance of the threats that such relationships may create. The significance will depend upon a number of factors including the individual's responsibilities on the assurance engagement, the closeness of the relationship and the role of the family member or other individual within the assurance client. Consequently, there is a wide spectrum of circumstances that will need to be evaluated and safeguards to be applied to reduce the threat to an acceptable level.

A.135 When an immediate family member of a member of the assurance team is a director, an officer or an employee of the assurance client in a position to exert direct and significant

influence over the subject matter information of the assurance engagement, or was in such a position during any period covered by the engagement, the threats to independence can only be reduced to an acceptable level by removing the individual from the assurance team. The closeness of the relationship is such that no other safeguard could reduce the threat to independence to an acceptable level. If application of this safeguard is not used, the only course of action is to withdraw from the assurance engagement. For example, in the case of an audit of financial statements, if the spouse of a member of the assurance team is an employee in a position to exert direct and significant influence over the preparation of the audit client's accounting records or financial statements, the threat to independence could only be reduced to an acceptable level by removing the individual from the assurance team.

A.136 When a close family member of a member of the assurance team is a director, an officer, or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement, threats to independence may be created. The significance of the threats will depend on factors such as:

- The position the close family member holds with the client; and
- The role of the professional on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Removing the individual from the assurance team;
- Where possible, structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the close family member; or
- Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.

A.137 In addition, self-interest, familiarity or intimidation threats may be created when a person who is other than an immediate or close family member of a member of the assurance team has a close relationship with the member of the assurance team and is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement. Therefore, members of the assurance team are responsible for identifying any such persons and for consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship and the role of the individual within the assurance client.

A.138 Consideration should be given to whether self-interest, familiarity or intimidation threats may be created by a personal or family relationship between a partner or employee of the firm who is not a member of the assurance team and a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement. Therefore partners and employees of the firm are responsible for identifying any such relationships and for

consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship, the interaction of the firm professional with the assurance team, the position held within the firm, and the role of the individual within the assurance client.

- A.139 An inadvertent violation of this section as it relates to family and personal relationships would not impair the independence of a firm or a member of the assurance team when:
- (a) The firm has established policies and procedures that require all professionals to report promptly to the firm any breaches resulting from changes in the employment status of their immediate or close family members or other personal relationships that create threats to independence;
 - (b) Either the responsibilities of the assurance team are re-structured so that the professional does not deal with matters that are within the responsibility of the person with whom he or she is related or has a personal relationship, or, if this is not possible, the firm promptly removes the professional from the assurance engagement; and
 - (c) Additional care is given to reviewing the work of the professional.
- A.140 When an inadvertent violation of this section relating to family and personal relationships has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or
 - Excluding the individual from any substantive decision-making concerning the assurance engagement.

EMPLOYMENT WITH ASSURANCE CLIENTS

- A.141 A firm or a member of the assurance team's independence may be threatened if a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement has been a member of the assurance team or partner of the firm. Such circumstances may create self-interest, familiarity and intimidation threats particularly when significant connections remain between the individual and his or her former firm. Similarly, a member of the assurance team's independence may be threatened when an individual participates in the assurance engagement knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future.
- A.142 If a member of the assurance team, partner or former partner of the firm has joined the assurance client, the significance of the self-interest, familiarity or intimidation threats created will depend upon the following factors:
- (a) The position the individual has taken at the assurance client.
 - (b) The amount of any involvement the individual will have with the assurance team.

- (c) The length of time that has passed since the individual was a member of the assurance team or firm.
- (d) The former position of the individual within the assurance team or firm.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Considering the appropriateness or necessity of modifying the assurance plan for the assurance engagement;
- Assigning an assurance team to the subsequent assurance engagement that is of sufficient experience in relation to the individual who has joined the assurance client;
- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary; or
- Quality control review of the assurance engagement.

In all cases, all of the following safeguards are necessary to reduce the threat to an acceptable level:

- (a) The individual concerned is not entitled to any benefits or payments from the firm unless these are made in accordance with fixed pre-determined arrangements. In addition, any amount owed to the individual should not be of such significance to threaten the firm's independence.
- (b) The individual does not continue to participate or appear to participate in the firm's business or professional activities.

A.143 A self-interest threat is created when a member of the assurance team participates in the assurance engagement while knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future. This threat can be reduced to an acceptable level by the application of all of the following safeguards:

- (a) Policies and procedures to require the individual to notify the firm when entering serious employment negotiations with the assurance client.
- (b) Removal of the individual from the assurance engagement.

In addition, consideration should be given to performing an independent review of any significant judgments made by that individual while on the engagement.

RECENT SERVICE WITH ASSURANCE CLIENTS

A.144 To have a former officer, director or employee of the assurance client serve as a member of the assurance team may create self-interest, self-review and familiarity threats. This would be particularly true when a member of the assurance team has to report on, for example, subject matter information he or she had prepared or elements of the financial statements he or she had valued while with the assurance client.

A.145 If, during the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter information of

the assurance engagement, the threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, such individuals should not be assigned to the assurance team.

- A.146 If, prior to the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter information of the assurance engagement, this may create self-interest, self-review and familiarity threats. For example, such threats would be created if a decision made or work performed by the individual in the prior period, while employed by the assurance client, is to be evaluated in the current period as part of the current assurance engagement. The significance of the threats will depend upon factors such as:
- The position the individual held with the assurance client;
 - The length of time that has passed since the individual left the assurance client; and
 - The role the individual plays on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Involving an additional professional accountant to review the work done by the individual as part of the assurance team or otherwise advise as necessary; or
- Discussing the issue with those charged with governance, such as the audit committee.

SERVING AS AN OFFICER OR DIRECTOR ON THE BOARD OF ASSURANCE CLIENTS

- A.147 If a partner or employee of the firm serves as an officer or as a director on the board of an assurance client the self-review and self-interest threats created would be so significant no safeguard could reduce the threats to an acceptable level. In the case of a financial statement audit engagement, if a partner or employee of a network firm were to serve as an officer or as a director on the board of the audit client the threats created would be so significant no safeguard could reduce the threats to an acceptable level. Consequently, if such an individual were to accept such a position the only course of action is to refuse to perform, or to withdraw from the assurance engagement.
- A.148 The position of Company Secretary has different implications in different jurisdictions. The duties may range from administrative duties such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally this position is seen to imply a close degree of association with the entity and may create self-review and advocacy threats.
- A.149 If a partner or employee of the firm or a network firm serves as Company Secretary for a financial statement audit client the self-review and advocacy threats created would

generally be so significant, no safeguard could reduce the threat to an acceptable level. When the practice is specifically permitted under local law, professional rules or practice, the duties and functions undertaken should be limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns.

A.150 Routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters is generally not perceived to impair independence, provided client management makes all relevant decisions.

LONG ASSOCIATION OF SENIOR PERSONNEL WITH ASSURANCE CLIENTS

A.151 Using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threat. The significance of the threat will depend upon factors such as:

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

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied to reduce the threat to an acceptable level. Such safeguards might include:

- Rotating the senior personnel off the assurance team;
- Involving an additional professional accountant who was not a member of the assurance team to review the work done by the senior personnel or otherwise advise as necessary; or
- Independent internal quality reviews.

FINANCIAL STATEMENT AUDIT CLIENTS THAT ARE LISTED ENTITIES

A.152 Using the same engagement partner or the same individual responsible for the engagement quality control review on a financial statement audit over a prolonged period may create a familiarity threat. This threat is particularly relevant in the context of the financial statement audit of a listed entity and safeguards should be applied in such situations to reduce such threat to an acceptable level. Accordingly in respect of the financial statement audit of listed entities:

- (a) The engagement partner and the individual responsible for the engagement quality control review should be rotated after serving in either capacity, or a combination thereof, for a pre-defined period, normally no more than seven years; and
- (b) Such an individual rotating after a pre-defined period should not participate in the audit engagement until a further period of time, normally two years, has elapsed.

A.153 When a financial statement audit client becomes a listed entity the length of time the engagement partner or the individual responsible for the engagement quality control review has served the audit client in that capacity should be considered in determining when the individual should be rotated. However, the person may continue to serve as the

engagement partner or as the individual responsible for the engagement quality control review for two additional years before rotating off the engagement.

- A.154 While the engagement partner and the individual responsible for the engagement quality control review should be rotated after such a pre-defined period, some degree of flexibility over timing of rotation may be necessary in certain circumstances. Examples of such circumstances include:
- Situations when the person's continuity is especially important to the financial statement audit client, for example, when there will be major changes to the audit client's structure that would otherwise coincide with the rotation of the person's; and
 - Situations when, due to the size of the firm, rotation is not possible or does not constitute an appropriate safeguard.

In all such circumstances when the person is not rotated after such a pre-defined period equivalent safeguards should be applied to reduce any threats to an acceptable level.

- A.155 When a firm has only a few people with the necessary knowledge and experience to serve as engagement partner or individual responsible for the engagement quality control review on a financial statement audit client that is a listed entity, rotation may not be an appropriate safeguard. In these circumstances the firm should apply other safeguards to reduce the threat to an acceptable level. Such safeguards would include involving an additional professional accountant who was not otherwise associated with the assurance team to review the work done or otherwise advise as necessary. This individual could be someone from outside the firm or someone within the firm who was not otherwise associated with the assurance team.

PROVISION OF NON-ASSURANCE SERVICES TO ASSURANCE CLIENTS

- A.156 Members have traditionally provided to their assurance clients a range of non-assurance services that are consistent with their skills and expertise. Assurance clients value the benefits that derive from having these firms, which have a good understanding of the business, bring their knowledge and skill to bear in other areas. Furthermore, the provision of such non-assurance services will often result in the assurance team obtaining information regarding the assurance client's business and operations that is helpful in relation to the assurance engagement. The greater the knowledge of the assurance client's business, the better the assurance team will understand the assurance client's procedures and controls, and the business and financial risks that it faces. The provision of non-assurance services may, however, create threats to the independence of the firm, a network firm or the members of the assurance team, particularly with respect to perceived threats to independence. Consequently, it is necessary to evaluate the significance of any threat created by the provision of such services. In some cases it may be possible to eliminate or reduce the threat created by application of safeguards. In other cases no safeguards are available to reduce the threat to an acceptable level.

A.157 The following activities would generally create self-interest or self-review threats that are so significant that only avoidance of the activity or refusal to perform the assurance engagement would reduce the threats to an acceptable level:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of the assurance client, or having the authority to do so.
- Determining which recommendation of the firm should be implemented.
- Reporting, in a management role, to those charged with governance.

A.158 The examples set out in paragraphs A.164 through A.203 are addressed in the context of the provision of non-assurance services to an assurance client. The potential threats to independence will most frequently arise when a non-assurance service is provided to a financial statement audit client. The financial statements of an entity provide financial information about a broad range of transactions and events that have effected the entity. The subject matter information of other assurance services, however, may be limited in nature. Threats to independence, however, may also arise when a firm provides a non-assurance service related to the subject matter, of a non-financial statement audit assurance engagement. In such cases, consideration should be given to the significance of the firm's involvement with the subject matter of the engagement, whether any self-review threats are created and whether any threats to independence could be reduced to an acceptable level by application of safeguards, or whether the engagement should be declined. When the non-assurance service is not related to the subject matter information, of the non-financial statement audit assurance engagement, the threats to independence will generally be clearly insignificant.

A.159 The following activities may also create self-review or self-interest threats:

- Having custody of an assurance client's assets.
- Supervising assurance client employees in the performance of their normal recurring activities.
- Preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction (for example, purchase orders, payroll time records, and customer orders).

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Making arrangements so that personnel providing such services do not participate in the assurance engagement;
- Involving an additional professional accountant to advise on the potential impact of the activities on the independence of the firm and the assurance team; or
- Other relevant safeguards set out in national regulations.

A.160 New developments in business, the evolution of financial markets, rapid changes in information technology, and the consequences for management and control, make it impossible to draw up an all-inclusive list of all situations when providing non-assurance services to an assurance client might create threats to independence and of the different safeguards that might eliminate these threats or reduce them to an acceptable level. In

general, however, a firm may provide services beyond the assurance engagement provided any threats to independence have been reduced to an acceptable level.

A.161 The following safeguards may be particularly relevant in reducing to an acceptable level threats created by the provision of non-assurance services to assurance clients:

- Policies and procedures to prohibit professional staff from making management decisions for the assurance client, or assuming responsibility for such decisions.
- Discussing independence issues related to the provision of non-assurance services with those charged with governance, such as the audit committee.
- Policies within the assurance client regarding the oversight responsibility for provision of non-assurance services by the firm.
- Involving an additional professional accountant to advise on the potential impact of the non-assurance engagement on the independence of the member of the assurance team and the firm.
- Involving an additional professional accountant outside of the firm to provide assurance on a discrete aspect of the assurance engagement.
- Obtaining the assurance client's acknowledgement of responsibility for the results of the work performed by the firm.
- Disclosing to those charged with governance, such as the audit committee, the nature and extent of fees charged.
- Making arrangements so that personnel providing non-assurance services do not participate in the assurance engagement.

A.162 Before the firm accepts an engagement to provide a non-assurance service to an assurance client, consideration should be given to whether the provision of such a service would create a threat to independence. In situations when a threat created is other than clearly insignificant, the non-assurance engagement should be declined unless appropriate safeguards can be applied to eliminate the threat or reduce it to an acceptable level.

A.163 The provision of certain non-assurance services to financial statement audit clients may create threats to independence so significant that no safeguard could eliminate the threat or reduce it to an acceptable level. However, the provision of such services to a related entity, division or discrete financial statement item of such clients may be permissible when any threats to the firm's independence have been reduced to an acceptable level by arrangements for that related entity, division or discrete financial statement item to be audited by another firm or when another firm re-performs the non-assurance service to the extent necessary to enable it to take responsibility for that service.

PREPARING ACCOUNTING RECORDS AND FINANCIAL STATEMENTS

A.164 Assisting a financial statement audit client in matters such as preparing accounting records or financial statements may create a self-review threat when the financial statements are subsequently audited by the firm.

A.165 It is the responsibility of financial statement audit client management to ensure that accounting records are kept and financial statements are prepared, although they may request the firm to provide assistance. If firm, or network firm, personnel providing such assistance make management decisions, the self-review threat created could not be reduced to an acceptable level by any safeguards. Consequently, personnel should not make such decisions. Examples of such managerial decisions include:

- Determining or changing journal entries, or the classifications for accounts or transaction or other accounting records without obtaining the approval of the financial statement audit client;
- Authorizing or approving transactions; and
- Preparing source documents or originating data (including decisions on valuation assumptions), or making changes to such documents or data.

A.166 The audit process involves extensive dialogue between the firm and management of the financial statement audit client. During this process, management requests and receives significant input regarding such matters as accounting principles and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. Technical assistance of this nature and advice on accounting principles for financial statement audit clients are an appropriate means to promote the fair presentation of the financial statements. The provision of such advice does not generally threaten the firm's independence. Similarly, the financial statement audit process may involve assisting an audit client in resolving account reconciliation problems, analyzing and accumulating information for regulatory reporting, assisting in the preparation of consolidated financial statements (including the translation of local statutory accounts to comply with group accounting policies and the transition to a different reporting framework such as International Financial Reporting Standards), drafting disclosure items, proposing adjusting journal entries and providing assistance and advice in the preparation of local statutory accounts of subsidiary entities. These services are considered to be a normal part of the audit process and do not, under normal circumstances, threaten independence.

GENERAL PROVISIONS

A.167 The examples in paragraphs A.168 through A.171 indicate that self-review threats may be created if the firm is involved in the preparation of accounting records or financial statements and those financial statements are subsequently the subject matter of an audit engagement of the firm. This notion may be equally applicable in situations when the subject matter information of the assurance engagement is not financial statements. For example, a self-review threat would be created if the firm developed and prepared prospective financial information and subsequently provided assurance on this prospective financial information. Consequently, the firm should evaluate the significance of any self-review threat created by the provision of such services. If the self-review threat is other than clearly insignificant safeguards should be considered and applied as necessary to reduce the threat to an acceptable level.

FINANCIAL STATEMENTS AUDIT CLIENTS THAT ARE NOT LISTED ENTITIES

A.168 The firm, or a network firm, may provide a financial statement audit client that is not a listed entity with accounting and bookkeeping services, including payroll services, of a routine or mechanical nature, provided any self-review threat created is reduced to an acceptable level. Examples of such services include:

- Recording transactions for which the audit client has determined or approved the appropriate account classification;
- Posting coded transactions to the audit client's general ledger;
- Preparing financial statements based on information in the trial balance; and
- Posting the audit client approved entries to the trial balance.

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Making arrangements so such services are not performed by a member of the assurance team;
- Implementing policies and procedures to prohibit the individual providing such services from making any managerial decisions on behalf of the audit client;
- Requiring the source data for the accounting entries to be originated by the audit client;
- Requiring the underlying assumptions to be originated and approved by the audit client; or
- Obtaining audit client approval for any proposed journal entries or other changes affecting the financial statements.

FINANCIAL STATEMENT AUDIT CLIENTS THAT ARE LISTED ENTITIES

A.169 The provision of accounting and bookkeeping services, including payroll services and the preparation of financial statements or financial information which forms the basis of the financial statements on which the audit report is provided, on behalf of a financial statement audit client that is a listed entity, may impair the independence of the firm or network firm, or at least give the appearance of impairing independence. Accordingly, no safeguard other than the prohibition of such services, except in emergency situations and when the services fall within the statutory audit mandate, could reduce the threat created to an acceptable level. Therefore, a firm or a network firm should not, with the limited exceptions below, provide such services to a listed entity that is a financial statement audit client.

A.170 The provision of accounting and bookkeeping services of a routine or mechanical nature to divisions or subsidiaries of a financial statement audit client that is a listed entity would not be seen as impairing independence with respect to the audit client provided that the following conditions are met:

- (a) The services do not involve the exercise of judgment.

- (b) The divisions or subsidiaries for which the service is provided are collectively immaterial to the audit client, or the services provided are collectively immaterial to the division or subsidiary.
- (c) The fees to the firm, or network firm, from such services are collectively clearly insignificant.

If such services are provided, all of the following safeguards should be applied:

- (a) The firm, or network firm, should not assume any managerial role nor make any managerial decisions.
- (b) The audit client should accept responsibility for the results of the work.
- (c) Personnel providing the services should not participate in the audit.

EMERGENCY SITUATIONS

- A.171 The provision of accounting and bookkeeping services to financial statement audit clients in emergency or other unusual situations, when it is impractical for the audit client to make other arrangements, would not be considered to pose an unacceptable threat to independence provided:
- (a) The firm, or network firm, does not assume any managerial role or make any managerial decisions;
 - (b) The audit client accepts responsibility for the results of the work; and
 - (c) Personnel providing the services are not members of the assurance team.

VALUATION SERVICES

- A.172 A valuation comprises the making of assumptions with regard to future developments, the application of certain methodologies and techniques, and the combination of both in order to compute a certain value, or range of values, for an asset, a liability or for a business as a whole. Such valuations include those performed for actuarial purposes.
- A.173 A self-review threat may be created when a firm or network firm performs a valuation for a financial statement audit client that is to be incorporated into the client's financial statements.
- A.174 If the valuation service involves the valuation of matters material to the financial statements and the valuation involves a significant degree of subjectivity, the self review threat created could not be reduced to an acceptable level by the application of any safeguard. Accordingly, such valuation services should not be provided or, alternatively, the only course of action would be to withdraw from the financial statement audit engagement.
- A.175 Performing valuation services for a financial statement audit client that are neither separately, nor in the aggregate, material to the financial statements, or that do not involve a significant degree of subjectivity, may create a self-review threat that could be reduced to an acceptable level by the application of safeguards. Such safeguards might include:

- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary;
- Confirming with the audit client their understanding of the underlying assumptions of the valuation and the methodology to be used and obtaining approval for their use;
- Obtaining the audit client's acknowledgement of responsibility for the results of the work performed by the firm; and
- Making arrangements so that personnel providing such services do not participate in the audit engagement.

In determining whether the above safeguards would be effective, consideration should be given to the following matters:

- (a) The extent of the audit client's knowledge, experience and ability to evaluate the issues concerned, and the extent of their involvement in determining and approving significant matters of judgment.
- (b) The degree to which established methodologies and professional guidelines are applied when performing a particular valuation service.
- (c) For valuations involving standard or established methodologies, the degree of subjectivity inherent in the item concerned.
- (d) The reliability and extent of the underlying data.
- (e) The degree of dependence on future events of a nature which could create significant volatility inherent in the amounts involved.
- (f) The extent and clarity of the disclosures in the financial statements.

A.176 When a firm, or a network firm, performs a valuation service for a financial statement audit client for the purposes of making a filing or return to a tax authority, computing an amount of tax due by the client, or for the purpose of tax planning, this would not create a significant threat to independence because such valuations are generally subject to external review, for example by a tax authority.

A.177 When the firm performs a valuation that forms part of the subject matter information of an assurance engagement that is not a financial statement audit engagement, the firm should consider any self-review threats. If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

PROVISION OF TAXATION SERVICES TO FINANCIAL STATEMENT AUDIT CLIENTS

A.178 In many jurisdictions, the firm may be asked to provide taxation services to a financial statement audit client. Taxation services comprise a broad range of services, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes. Such assignments are generally not seen to create threats to independence.

PROVISION OF INTERNAL AUDIT SERVICES TO FINANCIAL STATEMENT AUDIT CLIENTS

- A.179 A self-review threat may be created when a firm, or network firm, provides internal audit services to a financial statement audit client. Internal audit services may comprise an extension of the firm's audit service beyond requirements of generally accepted auditing standards, assistance in the performance of a client's internal audit activities or outsourcing of the activities. In evaluating any threats to independence, the nature of the service will need to be considered. For this purpose, internal audit services do not include operational internal audit services unrelated to the internal accounting controls, financial systems or financial statements.
- A.180 Services involving an extension of the procedures required to conduct a financial statement audit in accordance with International Standards on Auditing would not be considered to impair independence with respect to the audit client provided that the firm's or network firm's personnel do not act or appear to act in a capacity equivalent to a member of audit client management.
- A.181 When the firm, or a network firm, provides assistance in the performance of a financial statement audit client's internal audit activities or undertakes the outsourcing of some of the activities, any self-review threat created may be reduced to an acceptable level by ensuring that there is a clear separation between the management and control of the internal audit by client management and the internal audit activities themselves.
- A.182 Performing a significant portion of the financial statement audit client's internal audit activities may create a self-review threat and a firm, or network firm, should consider the threats and proceed with caution before taking on such activities. Appropriate safeguards should be put in place and the firm, or network firm, should, in particular, ensure that the audit client acknowledges its responsibilities for establishing, maintaining and monitoring the system of internal controls.
- A.183 Safeguards that should be applied in all circumstances to reduce any threats created to an acceptable level include ensuring that:
- (a) The audit client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the system of internal controls;
 - (b) The audit client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;
 - (c) The audit client, the audit committee or supervisory body approves the scope, risk and frequency of internal audit work;
 - (d) The audit client is responsible for evaluating and determining which recommendations of the firm should be implemented;
 - (e) The audit client evaluates the adequacy of the internal audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining and acting on reports from the firm; and

- (f) The findings and recommendations resulting from the internal audit activities are reported appropriately to the audit committee or supervisory body.

A.184 Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the financial statement audit engagement and with different reporting lines within the firm.

PROVISION OF IT SYSTEMS SERVICES TO FINANCIAL STATEMENT AUDIT CLIENTS

A.185 The provision of services by a firm or network firm to a financial statement audit client that involve the design and implementation of financial information technology systems that are used to generate information forming part of a client's financial statements may create a self-review threat.

A.186 The self-review threat is likely to be too significant to allow the provision of such services to a financial statement audit client unless appropriate safeguards are put in place ensuring that:

- (a) The audit client acknowledges its responsibility for establishing and monitoring a system of internal controls;
- (b) The audit client designates a competent employee, preferably within senior management, with the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system;
- (c) The audit client makes all management decisions with respect to the design and implementation process;
- (d) The audit client evaluates the adequacy and results of the design and implementation of the system; and
- (e) The audit client is responsible for the operation of the system (hardware or software) and the data used or generated by the system.

A.187 Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the financial statement audit engagement and with different reporting lines within the firm.

A.188 The provision of services by a firm, or network firm, to a financial statement audit client which involve either the design or the implementation of financial information technology systems that are used to generate information forming part of a client's financial statements may also create a self-review threat. The significance of the threat, if any, should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

A.189 The provision of services in connection with the assessment, design and implementation of internal accounting controls and risk management controls are not considered to create a threat to independence provided that firm or network firm personnel do not perform management functions.