

## REVISION OF SECTION 290

### INDEPENDENCE – AUDIT AND REVIEW ENGAGEMENTS

#### **Internal Audit Services**

##### *General Provisions*

- 290.186 The scope and objectives of internal audit activities vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance. Internal audit activities may include one or more of the following:
- (a) Monitoring of internal control – reviewing controls, monitoring their operation and recommending improvements thereto;
  - (b) Examination of financial and operating information – reviewing the means used to identify, measure, classify and report financial and operating information, and specific inquiry into individual items including detailed testing of transactions, balances and procedures;
  - (c) Review of the economy, efficiency and effectiveness of operating activities including non-financial activities of an entity; and
  - (d) Review of compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.
- 290.187 Internal audit services involve assisting the audit client in the performance of its internal audit activities. The provision of internal audit services to an audit client creates a self-review threat to independence if the firm intends to use the internal audit work in the course of a subsequent external audit. Assisting an audit client in the performance of a significant part of the client's internal audit activities increases the possibility that firm personnel providing internal audit services will assume a management responsibility. If the firm's personnel assume a management responsibility when providing internal audit services to an audit client, the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm should ensure that its personnel do not assume a management responsibility when providing internal audit services to an audit client.
- 290.188 Examples of internal audit services that involve assuming management responsibilities include:
- (a) Setting internal audit policies or the strategic direction of internal audit activities;
  - (b) Directing and taking responsibility for the actions of the entity's internal audit employees;
  - (c) Deciding which recommendations resulting from internal audit activities should be implemented;
  - (d) Reporting the results of the internal audit activities to those charged with governance on behalf of management;

- (e) Performing procedures that form part of the internal control, such as reviewing and approving changes to employee data access privileges;
- (f) Taking responsibility for designing, implementing and maintaining internal control; and
- (g) Performing outsourced internal audit services, comprising all or a substantial portion of the internal audit function, where the firm is responsible for determining the scope of the internal audit work and may have responsibility for one or more of the matters noted in (a) – (f).

290.189 To ensure that, in performing internal audit services, the firm does not assume a management responsibility, the firm should only provide internal audit services to an audit client if all of the following conditions are met:

- (a) The client designates an appropriate and competent resource, preferably within senior management, to be responsible for internal audit activities and to acknowledge responsibility for designing, implementing, and maintaining internal control;
- (b) The client's management or those charged with governance reviews, assesses and approves the scope, risk and frequency of the internal audit services;
- (c) The client's management evaluates the adequacy of the internal audit services and the findings resulting from their performance;
- (d) The client's management evaluates and determines which recommendations resulting from internal audit services to implement and manages the implementation process; and
- (e) The client's management reports to those charged with governance the significant findings and recommendations resulting from the internal audit services.

290.190 When a firm uses the work of an internal audit function, international auditing standards require the performance of procedures to evaluate the adequacy of that work. When a firm accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the external audit, a self-review threat is created because of the possibility that the audit team will use the results of the internal audit service without appropriately evaluating those results or exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm. The significance of the threat will depend on factors such as:

- The materiality of the related financial statement amounts;
- The risk of misstatement of the assertions related to those financial statement amounts; and
- The degree of reliance that will be placed on the internal audit service.

The significance of the threat should be evaluated and, if the threat is not 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 using professionals who are not members of the audit team to perform the internal audit service.

*Audit Clients that are Public Interest Entities*

290.191 In the case of an audit client that is a public interest entity, a firm should not provide internal audit services that relate to the internal accounting controls, financial systems or financial statements.

290.192 A firm is not, however, precluded from providing to an audit client that is a public interest entity a non-recurring internal audit service to evaluate a specific matter (such as assisting the client in an investigation of a suspected fraud) provided the conditions in paragraph 290.189 are met, the service would otherwise be permitted under Section 290, and safeguards are applied as necessary to reduce any threat that is not clearly insignificant to an acceptable level.

**Fees**

**Fees – Relative Size**

290.213 When the total fees from an audit client represent a large proportion of the total fees of the firm expressing the audit opinion, the dependence on that client and concern about losing the client may create a self-interest threat. The significance of the threat will depend on factors such as:

- The operating structure of the firm;
- Whether the firm is well established or new; and
- The significance of the client qualitatively and/or quantitatively to the firm.

The significance of the threat should be evaluated and, if the threat is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Taking steps to reduce the dependency on the audit client;
- External quality control reviews; or
- Consulting a third party, such as a professional regulatory body or another professional accountant, on key audit judgments.

290.214 A self-interest threat may also be created when the fees generated from an audit client represent a large proportion of the revenue from an individual partner's clients or a large proportion of the revenue of an individual office of the firm. The significance of the threat will depend upon factors such as:

- The significance of the client qualitatively and/or quantitatively to the partner or office; and

- The extent to which the remuneration of the partner, or the partners in the office, is dependent upon the fees generated from the client.

The significance of the threat should be evaluated and, if the threat is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Taking steps to reduce the dependency on the audit client;
- Having an additional professional accountant review the work or otherwise advise as necessary; or
- Regular independent internal or external quality reviews of the engagement.

*Audit Clients that are Public Interest Entities*

290.215 In the case of an audit client that is an entity of public interest when, for two consecutive years, the total fees from the client and its related entities (subject to the considerations in paragraph 290.24) represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, the self-interest threat would be too significant unless the firm discloses to those charged with governance of the audit client the fact that the total of such fees represents more than 15% of the total fees received by the firm and discusses which of the safeguards below will be applied to reduce the threat to an acceptable level:

- After the audit opinion on the second year's financial statements has been issued, and before the issuance of the audit opinion on the third year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, or a professional regulatory body performs a review that is equivalent to an engagement quality control review ("a post-issuance review"); or
- Prior to the issuance of the audit opinion on the second year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, performs an engagement quality control review or a professional regulatory body performs a review that is equivalent to an engagement quality control review ("a pre-issuance review")

When the total fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review shall be performed.

Thereafter, when the fees continue to exceed 15%, each year the disclosure to and discussion with those charged with governance should occur and one of the above safeguards should be applied. If the fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review shall be performed.

## **Fees – Overdue**

290.216 A self-interest threat may be created if fees due from an audit client remain unpaid for a long time, especially if a significant part is not paid before the issue of the audit report for the following year. Generally the firm should require payment of such fees before the audit report is issued. If the fee remains unpaid after the report has been issued, the significance of the threat should be evaluated. If the threat is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include having an additional professional accountant who did not take part in the audit engagement, provide advice, or review the work performed. The firm should also consider whether the overdue fees might be regarded as being equivalent to a loan to the client and whether, because of the significance of the overdue fees, it is appropriate for the firm to be re-appointed.

## **Contingent Fees**

290.217 **Contingent fees**\* are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the services performed by the firm. For the purposes of this section, a fee is not regarded as being contingent if it is established by a court or other public authority.

290.218 A contingent fee charged directly or indirectly by a firm in respect of an audit engagement creates a self-interest threat that cannot be reduced to an acceptable level by applying any safeguard. Accordingly, a firm should not enter into any such fee arrangement.

290.219 A contingent fee charged directly or indirectly by a firm in respect of a non-assurance service provided to an audit client may also create a self-interest threat. No safeguards can reduce the threat to an acceptable level if:

- (a) The fee is charged by the firm expressing the opinion on the financial statements and the fee is material or expected to be material to that firm;
- (b) The fee is charged by a network firm that participates in a significant part of the audit and the fee is material or expected to be material to that firm; or
- (c) If the non-assurance service has a material effect on the financial statements and that effect will be the subject of a significant or future or contemporary audit judgment.

Accordingly, such arrangements should not be accepted.

290.220 For other contingent fee arrangements charged by a firm for a non-assurance service to an audit client, the significance of the threats will depend on factors such as:

- The range of possible fee amounts;

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\* See Definitions.

- Whether an appropriate authority determines the outcome of the matter upon which the contingent fee will be determined;
- The nature of the service; and
- The effect of the event or transaction on the financial statements.

The significance of the threats should be evaluated and, if the threats are not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threats or reduce them to an acceptable level. Such safeguards might include:

- Having an additional professional accountant review the relevant audit work or otherwise advise as necessary; or
- Using professionals who are not members of the audit team to perform the non-assurance service.

## **REVISION OF SECTION 291**

### **INDEPENDENCE – OTHER ASSURANCE ENGAGEMENTS**

#### **Contingent Fees**

- 291.151 Contingent fees are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the services performed by the firm. For the purposes of this section, fees are not regarded as being contingent if it is established by a court or other public authority.
- 291.152 A contingent fee charged directly or indirectly by a firm in respect of an assurance engagement creates a self-interest threat that cannot be reduced to an acceptable level by applying any safeguard. Accordingly, a firm should not enter into any such fee arrangement.
- 291.153 A contingent fee charged directly or indirectly by a firm in respect of a non-assurance service provided to an assurance client may also create a self-interest threat. If the non-assurance service has a material effect on the subject matter information and that effect will be the subject of a future or contemporary assurance judgment no safeguards can reduce the threat to an acceptable level. Accordingly, such arrangements should not be accepted.
- 291.154 For other types of contingent fee arrangements charged by a firm for a non-assurance service to an assurance client, the significance of the threats will depend on factors such as:
- The range of possible fee amounts;
  - Whether an appropriate authority determines the outcome of the matter upon which the contingent fee will be determined;
  - The nature of the service; and
  - The effect of the event or transaction on the financial statements.

The significance of the threats should be evaluated and, if the threats are not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threats or reduce them to an acceptable level. Such safeguards might include:

- Having an additional professional accountant review the relevant assurance work or otherwise advise as necessary; or
- Using professional who are not members of the assurance team to perform the non-assurance service.

## **Definitions**

Contingent fee    A fee calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm. A fee that is established by a court or other public authority is not a contingent fee.