

Structure of the Code—A Possible Approach to Restructuring Section 290¹ (CLEAN)

**THESE SCHEDULES ARE NOT PROPOSALS. THEY HAVE BEEN
DEVELOPED TO EXPLORE THE PRINCIPLES, RATHER THAN PRECISE
WORDING.**

[These general paragraphs could cover all provisions]

Scope

Paragraphs 290.XXX through 290.YYY apply to firms and professional accountants in public practice and set out standards with respect to financial interests that apply to firms, professional accountants, or both, as the case may be.

Where a provision applies to a firm, a professional accountant within a firm, an employee of a firm, an immediate or close family member of such a person or to another person with whom the professional accountant or employee has a relationship, the responsible partner identified pursuant to Paragraph ??? may be held accountable for compliance with any such provision.

Where a provision applies to a professional accountant, an immediate or close family member of the professional accountant or to another person with whom the professional accountant has a relationship, the professional accountant may be held accountable for compliance with any such provision.

Definitions

Definitions as set out in ????? of this Code apply to this section.

References to “clients” include related entities of those clients, as set out in Paragraph ????? of this Code.

References to “firms” include network firms, as set out in Paragraph ????? of this Code.

GENERAL REQUIREMENT

290.NEW1 A firm, a professional accountant, or both of them, shall not perform an audit engagement for a client of the firm unless both the professional accountant and the firm comply with each of the provisions of Paragraphs 290.XXX through 290.YYY that pertains to each of them and, where so specified by a particular provision, those with whom they have family or other relationships.

¹ Section 290, *Independence – Audit and Review Engagements*

FINANCIAL INTERESTS

Purpose

The holding of financial interest in an audit client or a related entity of the audit client by an auditor, or by those who have relationships with an auditor, may create a self-interest threat that impairs the auditor's objectivity and compromises the proper exercise of professional judgement and skepticism that is necessary to maintain independence from the audit client. This standard establishes requirements and provides guidance for auditors with respect to such financial interests.

Compliance with Conceptual Framework in Relation to Financial Interests

290.NEW2 Subject to the specific requirements of Paragraphs 290.??? through 290.???, **THE FIRM** shall evaluate the significance of any threat created in relation to an audit engagement and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level when:

- (a) a firm,
 - (b) a professional accountant within the firm,
 - (c) another employee of the firm,
 - (d) an immediate or close family member of any of those individuals, or
 - (e) another person who has a relationship of any of those individuals,
- holds a financial interest in
- (i) the audit client,
 - (ii) an entity which holds a controlling interest in the audit client, or
 - (iii) an entity in which the audit client or a director, officer or controlling owner of the audit client also holds a financial interest.

Financial Interests specifically identified as threats

Interest Held by Close Family Member

290.105 A person shall not participate as a member of an audit team if that person has a close family member who the team member knows has a direct financial interest or a material indirect financial interest in the audit client, unless the significance of the threat so created is evaluated **BY THE FIRM** and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Interest Held by Firm's Retirement Plan

290.107 When a firm's retirement benefit plan holds a direct or material indirect financial interest in an audit client, the significance of the threat so created shall be evaluated **BY THE FIRM** and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Common Interest with Directors, Officers, Owners

- 290.113 When a firm, a member of the audit team, or a member of that individual's immediate family holds a financial interest in an entity and a director, officer or controlling owner of the audit client is also known to have a financial interest in that entity, the significance of any threat so created shall be evaluated **by the firm** and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Interests Held by Others Not Otherwise Identified

- 290.115 When a member of the audit team knows that a financial interest is held in an audit client by:
- (a) Any partner or professional employee of the firm, other than those referred to in Paragraphs 290.??? through 290.???, or an immediate family member of such an individual; or
 - (b) Any individual with a close personal relationship with a member of the audit team,
- the significance of any threat so created shall be evaluated **BY THE FIRM** and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Financial Interests Specifically Not Permitted

Interests Held by the Firm, a Team Member or Immediate Family

- 290.104 The firm, a member of the audit team, or a member of that individual's immediate family, shall not hold a direct financial interest or a material indirect financial interest in the audit client.

Interests Held in Parent Companies

- 290.106 When an audit client is material to an entity and the entity has a controlling interest in the audit client, the firm, a member of the audit team, or a member of that individual's immediate family shall not hold a direct or material indirect financial interest in that entity.

Interests Held by Others in the Firm

- 290.108 Any other partner in an office in which an engagement partner practices in connection with the audit engagement, or the immediate family members of any such other partner, shall not hold a direct financial interest or a material indirect financial interest in the audit client.
- 290.109 When the engagement partner is located in a different office from that of the other members of the audit team, **THE ENGAGEMENT PARTNER** shall exercise professional judgment to determine in which office the partner practices in connection with that engagement.
- 290.110 Any other partners and managerial employees who provide non-audit services to the audit client and whose involvement is **MORE THAN MINIMAL**, or their immediate family members, shall not hold a direct financial interest or a material indirect financial interest in the audit client.

290.111 Notwithstanding the requirements set out in 290.108, 109 and 110, the immediate family member described therein may hold a direct financial interest or a material indirect financial interest in an audit client, provided that:

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

Interests Held in Another Entity

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

- (i) The financial interests are immaterial to the member of the audit team, that individual's immediate family, the firm and the audit client; and
- (ii) The audit client cannot exercise significant influence over the entity.

Notwithstanding the requirements set out in 290.112(above), an individual may participate on the audit team for an audit client if, prior to that individual becoming a member of the audit team, the individual or the member of that individual's immediate family, either:

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

Interest Held as Trustee

290.114 None of the following shall hold, as trustee, a direct financial interest or a material indirect financial interest in the audit client:

- (a) A firm, a member of the audit team, or a member of that individual's immediate family;
- (b) Any other partner in the office in which the engagement partner practices in connection with that audit or review;
- (c) Other partners and managerial employees who provide non-assurance services to that audit client and whose involvement is **MORE THAN MINIMAL**, or their immediate family members,

unless:

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

- (iv) The trustee, an immediate family member of the trustee, or the firm cannot significantly influence any investment decision involving a financial interest in the audit client.

Unintended Acquisition of Interests

290.116 When a firm or a partner or employee of the firm, or a member of that individual's immediate family, receives a direct financial interest or a material indirect financial interest in an audit client **AS A RESULT OF CIRCUMSTANCES BEYOND THE CONTROL OF THE FIRM OR THE INDIVIDUAL** and such interest would not be permitted to be held pursuant to the requirements set out in 290.??? through ???, then:

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

Application and Other Explanatory Material

General

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

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

290.103 Some financial interests are held through an intermediary (for example, a collective investment vehicle, estate or trust). The determination of whether such financial interests are direct or indirect will depend upon whether the beneficial owner has control over the investment vehicle or the ability to influence its investment decisions. When control over the investment vehicle or the ability to influence investment decisions exists, this Code defines that financial interest to be a direct financial interest. Conversely, when the beneficial owner of the financial interest has no control over the investment vehicle or ability to influence its investment decisions, this Code defines that financial interest to be an indirect financial interest.

Applying the Conceptual Framework to Specific Threats

290.105 When a member of the audit team has a close family member who the audit team member knows has a direct financial interest or a material indirect financial interest in the audit client,

a self-interest threat is created. Paragraph 290.105 requires the significance of such a threat to be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. The significance of the threat will depend on factors such as:

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

Examples of safeguards include:

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

290.113 A self-interest, familiarity or intimidation threat may be created if a member of the audit team, or a member of that individual's immediate family, or the firm, has a financial interest in an entity when a director, officer or controlling owner of the audit client is also known to have a financial interest in that entity. Paragraph 290.113 requires the significance of any such threat to be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. The existence and significance of any threat will depend upon factors such as:

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

Examples of safeguards include:

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

290.115 Paragraph 290.115 requires members of the audit team to determine whether a self-interest threat is created by any known financial interests in the audit client held by other individuals including:

- a) Partners and professional employees of the firm, other than those referred to above, or their immediate family members; and
- b) Individuals with a close personal relationship with a member of the audit team.

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

- The firm's organizational, operating and reporting structure; and

- The nature of the relationship between the individual and the member of the audit team.

Examples of safeguards include:

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

Unintended Acquisitions of Interests

290.NEW3 (this could just replace 290.116 but explain what might constitute CIRCUMSTANCES BEYOND THE CONTROL OF THE FIRM OR THE INDIVIDUAL)

Paragraph 290.116 sets out a specific exception to the requirements of Paragraphs 290.??? through ??? that would otherwise apply when a firm or a partner or employee of the firm, or a member of that individual's immediate family, receives a direct financial interest or a material indirect financial interest in an audit client **AS A RESULT OF CIRCUMSTANCES BEYOND THE CONTROL OF THE FIRM OR THE INDIVIDUAL**. Examples of such circumstances might include the receipt of the financial interest by way of an inheritance, gift or as a result of a merger.

(290.117 deleted as it is replaced by breaches provisions)

BUSINESS RELATIONSHIPS

Purpose

A close business relationship between an auditor, or those who have relationships with an auditor, and the audit client or its management, arises from a commercial relationship or common financial interest. Such a close business relationship may create self-interest or intimidation threats (*from existing 290.124*) that impair the auditor's objectivity and compromises the proper exercise of professional judgement and skepticism that is necessary to maintain independence from the audit client. This standard establishes requirements and provides guidance for auditors with respect to such business relationships.

Compliance with Conceptual Framework in Relation to Business Relationships

290.NEW2 Subject to the specific requirements of Paragraphs 290.??? through 290.???, **THE FIRM** shall evaluate the significance of any threat created in relation to an audit engagement and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level when a firm, a professional accountant within the firm, another employee of the firm, or an immediate family member of any of those individuals has a close business relationship with the audit client or its management.

Business Relationships Specifically Identified as Threats

Immediate Family Relationships

290.124 When an immediate family member of the member of the audit team has a close business relationship with the audit client or its management, the significance of any threat so created shall be evaluated **BY THE FIRM** and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Purchase of Goods or Services

290.126 When the firm, or a member of the audit team, or a member of that individual's immediate family, purchases goods **OR??** services from an audit client, the significance of any threat so created shall be evaluated **BY THE FIRM** and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level.

Business Relationships Specifically Not Permitted

Firm or Audit Team Member Relationships

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

Common Interests in Closely-Held Entities

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

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

Application and Other Explanatory Material

General

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

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

Possible Safeguards

290.126(b) Examples of safeguards which may be available to eliminate or reduce a threat created by a close business relationship include:

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

Purchase of Goods or Services

290.126(a) The purchase of goods **OR??** services from an audit client by the firm, or a member of the audit team, or a member of that individual's immediate family, does not generally create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions may be of such a nature or magnitude that they create a self-interest threat. Paragraph 290.124.2 requires the evaluation of the significance of any such threat and application of safeguards when necessary to eliminate the threat or reduce it to an acceptable level.

VALUATION SERVICES

Purpose (comes from 175 & 176)

A valuation comprises the making of assumptions with regard to future developments, the application of appropriate methodologies and techniques, and the combination of both to compute a certain value, or range of values, for an asset, a liability or for a business as a whole. Performing valuation services for an audit client may create a self-review threat that impairs the auditor's objectivity and compromises the proper exercise of professional judgement and skepticism that is necessary to maintain independence from the audit client. This standard establishes requirements and provides guidance for auditors with respect to the provision of valuation services to an audit client.

Compliance with Conceptual Framework in relation to valuation services

290.NEW2 (*This picks up T&S requirement of existing 290.176*) Subject to the specific requirements of Paragraphs 290.??? through 290.???, when a firm performs a valuation service for an audit client of the firm, **THE FIRM** shall evaluate the significance of any threat created in relation to an audit engagement and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level.

Valuation Services Specifically Not Permitted

Audit Clients That Are Not Public Interest Entities

290.179 A firm shall not provide a valuation service for an audit client that is not a public interest entity if the valuation service has a material effect on the financial statements on which the firm will express an opinion and the valuation involves a significant degree of subjectivity.

Audit Clients That Are Public Interest Entities

290.180 A firm shall not provide a valuation services to an audit client that is a public interest entity if the valuations service would have a material effect, separately or in the aggregate, on the financial statements on which the firm will express an opinion.

Application and Other Explanatory Material

General

- 290.176 The existence and significance of any threat created by the performance of a valuation service for an audit client will depend on factors such as:
- Whether the valuation will have a material effect on the financial statements.
 - The extent of the client's involvement in determining and approving the valuation methodology and other significant matters of judgment.
 - The availability of established methodologies and professional guidelines.
 - For valuations involving standard or established methodologies, the degree of subjectivity inherent in the item.
 - The reliability and extent of the underlying data.

- The degree of dependence on future events of a nature that could create significant volatility inherent in the amounts involved.
- The extent and clarity of the disclosures in the financial statements.

Examples of safeguards include:

- Having a professional who was not involved in providing the valuation service review the audit or valuation work performed; or
- Making arrangements so that personnel providing such services do not participate in the audit engagement.

290.177 Certain valuations do not involve a significant degree of subjectivity. This is likely the case where the underlying assumptions are either established by law or regulation, or are widely accepted and when the techniques and methodologies to be used are based on generally accepted standards or prescribed by law or regulation. In such circumstances, the results of a valuation performed by two or more parties are not likely to be materially different.

Valuations for Tax Purposes

290.178 If a firm is requested to perform a valuation to assist an audit client with its tax reporting obligations or for tax planning purposes and the results of the valuation will not have a direct effect on the financial statements, the provisions included in paragraph 290.191 apply.