

MEETING: 7 DECEMBER 2017

REPORT BY: SECRETARY TO THE COMMISSION

ETHICAL ADVICE

Purpose

1. This report proposes to the Commission how it sources ethical advice, both in relation to the Financial Reporting Council Ethical Standard and the Ethical Standards in Public Life Framework.

Background

2. At its meeting on 12 October 2017, the Commission endorsed the new audit quality framework. In doing so, it noted that further discussion between the Secretary and Assistant Auditor General would take place with regard to the role of Ethics Partner, including ethical advice in relation to, for example, non-audit services, to be reported further to the Commission. This paper reports on those discussions.
3. The paper recognises that the Commission needs support in relation to, firstly, the Financial Reporting Council (FRC) Ethical Standard, which specifies ethical requirements of auditors in both the private and the public sectors; and secondly, the Ethical Standards in Public Life Framework, which sets out the requirements of the ethical conduct of members of the Accounts Commission.

Ethical Standard and Ethics Partner

4. Ethical and audit engagement standards are issued by the FRC for auditors in the private sector. The FRC states that these also apply to “public sector financial statements audits in the UK including those carried out for the national audit agencies”. The FRC notes that while “the standards governing the conduct and reporting of financial statements audits are a matter for the national audit agencies to determine.... the heads of the agencies in the UK have chosen to adopt the ethical, engagement and quality control standards issued by the FRC for audits as the basis of their approach to the audit of financial statements.”¹
5. The 2016 Code of Audit Practice approved by the Commission and the Auditor General requires auditors appointed by them – thus Audit Scotland and the appointed firms - to carry out their audits in accordance with those standards as a term of their appointment.
6. The FRC Ethical Standard sets out that the firm (including for this purpose Audit Scotland) shall designate an individual possessing the necessary seniority, relevant experience, authority and leadership levels (the ‘Ethics Partner’) as having responsibility for ensuring the firm’s compliance with the requirements of the Ethical Standard.²
7. At its meeting on 13 November 2014, the Commission agreed as a matter of policy to adopt the principles of the FRC standards, particularly the Ethical Standard, to its own work. The Commission took the view that whilst it has appointed the local auditor and

¹ Financial Reporting Council, [Scope and Authority of Audit and Assurance Pronouncements](#), March 2013.

² Financial Reporting Council, [Ethical Standard 2016](#).

thus does not carry out financial statements audits, it does publish performance audit reports in its own name and issues findings on reports by the Controller of Audit that it considers, and thus it is acting as an auditor in relation to performance audits and as a significant element of the overall audit process when it issues findings.

8. The Ethical Standard recognises that “in the public sector the statutory scope of the audit can extend beyond financial statements to include reporting on arrangements for the proper conduct of [an audited body’s] affairs, management of its performance or use of its resources”.³ Nevertheless, the Standard is strongly based around the core work being a statutory audit of financial statements, and thus strictly speaking the “audit” role of the Commission does not fall within the technical definition. Consequently, there is no requirement for there to be an Ethics Partner as defined in the Ethical Standard. It is, however, sensible for the Commission to acknowledge the relevance and importance of the Ethical Standard and be aware that it does apply to all of their appointed auditors including Audit Scotland staff.
9. The Assistant Auditor General has for a number of years provided the Commission with advice on matters relating to the FRC Ethical Standard. The new audit quality framework – elsewhere on today’s agenda - sets out that the Director of Audit Services will now be the Ethics Partner for Audit Scotland (as an auditor, as discussed in paragraph 5 above). This is a sensible arrangement given the requirements around seniority and experience as discussed in paragraph 6 above, and it broadly reflects what one would expect to see in audit firms. This arrangement is however less fitting for the Commission given its role of procuring the audit, its need for assurance around the quality of the audit done by auditors, and its requirements around the independence of the audit (discussed in paragraph 12 below). It would therefore seem sensible that this role be fulfilled in another way.
10. As a result of the review of audit quality arrangements, Audit Scotland has revised its structure to establish an Appointments and Assurance Team (AAT), led by an assistant director. The audit quality framework sets out that the AAT is to:
 - provide independent assurance on audit quality and support the implementation of the framework across all audit work and providers
 - provide advice and guidance to the Accounts Commission and the Auditor General on ethical standards issues in accordance with FRC's revised Ethical Standard 2016.
11. In the AAT, therefore, there is the opportunity for the Commission to have a source of independent ethical advice which addresses any potential conflict of interest around its role and relationship with auditors – either actual or perceived – as indicated in paragraph 10. It is therefore proposed that the Assistant Director, Appointments and Assurance fulfil such a role. In doing so, the Assistant Director can still liaise when appropriate with Audit Scotland’s Ethics Partner, for example around technical issues associated with the Ethical Standard; and with the Commission Secretary, on matters associated with reputational risk to the Commission. Most importantly, however, it is the Assistant Director who is acting as the advisor to the Commission in this regard.

Non-audit services

12. Auditors can carry out additional work for an audited body beyond the audit. This is defined in the Ethical Standard as non-audit services. Non-audit services represent a risk to the quality and independence of the audit, for example around self-interest or self-

³ Financial Reporting Council, [Ethical Standard 2016](#), Paragraph I1

review. The Ethical Standard sets limits on what work auditors can do, and how much they can do.

13. The audit quality framework sets out that independence underpins the approach to audit quality. The Accounts Commission and Auditor General are independent of the audited bodies within their remits. Audit appointments are therefore only made by the Commission and Auditor General after consideration of actual or potential conflicts of interest. Accordingly, auditors must seek agreement from the Commission or Auditor General to undertake such non-audit services. Any proposed non-audit services need to be considered carefully in line with the FRC Ethical Standard and taking into account the wider scope of public audit before approval is given.
14. The audit quality framework sets out that one of the responsibilities of the AAT is ensuring that non-audit services are appropriate and compliant with the FRC Ethical Standard. It would seem sensible, therefore, that if the Assistant Director, Appointments and Assurance is to be designated as the source of independent advice to the Commission on matters in relation to the Ethical Standard, the Assistant Director can also fulfil the Commission's interest in approving applications for non-audit services. It is proposed, therefore, that the Commission formally delegates responsibility to the Assistant Director to consider such requests and approve them on the Commission's behalf.
15. Part of this delegation will be a responsibility for the Assistant Director to:
 - Liaise with the Commission Secretary where appropriate to discuss matters relating to reputational risk of the Commission.
 - Report to the Commission twice a year on how such requests have been dealt with (this is in line with the commitment in the audit quality framework that the AAT will report the number and value of requests for non-audit services to the Commission).

Standards Officer

16. The Commission is subject to the Ethical Standards in Public Life framework.⁴ Part of this framework is the requirement to have a Standards Officer. The role of the Standards Officer is, in summary:
 - Promoting and maintaining high standards of conduct through advice, support and training to members on the Ethical Standards framework, including the Members' Code of Conduct
 - Maintaining an approach to registering of interests
 - Having an investigatory role if local resolution is attempted in respect of complaints or concerns made about a member's conduct, or if this fails, reporting any breach to the Commissioner for Ethical Standards in Public Life in Scotland
 - Acting as the principal liaison officer between the Commission, the Ethical Standards Commissioner and the Standards Commission in connection with any

⁴ The Ethical Standards in Public Life framework was established by the Ethical Standards in Public Life etc. (Scotland) Act 2000 to ensure that the highest standards of behaviour were maintained by local authority councillors and members of certain public bodies, including the Accounts Commission. The framework consists of a Code of Conduct, the Standards Commission for Scotland (to hold hearings into alleged breaches of the Codes), and what is currently known as the Commissioner for Ethical Standards in Public Life in Scotland (to receive and investigate complaints about non-compliance).

complaints against a member of the body in relation to the Ethical Standards Framework.⁵

17. At its meeting on 9 June 2016, the Commission agreed to designate the Secretary to the Commission as Standards Officer.
18. As noted in paragraph 7, at its meeting on 13 November 2014, the Commission agreed as a matter of policy to adopt the principles of the FRC standards, particularly the FRC Ethical Standard, to its own work. In doing so, the Commission agreed to modify its Member Code of Conduct to reflect requirements of the FRC Ethical Standard. Any modification of the member code requires approval by Scottish Ministers. The Commission's proposal remains under discussion with the Local Government Minister and with the Commissioner for Ethical Standards, as there are matters to be resolved about enforcement of any modified Code.
19. Meantime, however, given the Commission's desire to at least act within the spirit of the FRC Ethical Standard which is to be reflected in its Member Code of Conduct, there will likely be substantial liaison between the Secretary in his role as Standards Officer and the Assistant Director, Appointments and Assurance in her role as a source of advice to the Commission on the FRC Ethical Standard

Conclusion

20. The Commission is asked to:
 - a) Agree not to designate an Ethics Partner for the Commission
 - b) Agree that the Assistant Director, Appointments and Assurance, be designated as the source of advice to the Commission on the FRC Ethical Standard
 - c) Agree to delegate to the Assistant Director, Appointments and Assurance, to consider for approval requests for non-audit services on the Commission's behalf, liaising with the Commission Secretary as appropriate and reporting to the Commission twice a year on how such requests have been dealt with
 - d) Note the role of the Commission Standards Officer and the link with the FRC Ethical Standard, and thus the likely collaboration with the Assistant Director in this regard.

Paul Reilly
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1 December 2017

⁵ Standards Commission, 2015, Advice note on the role of a standards officer