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ETHICAL STANDARDS APPLICATION GUIDANCE

This section of the Staff Handbook describes the application of the Ethical Standard, which was issued by the Financial Reporting Council (FRC) in June 2016, to Audit Scotland.

Introduction

1. The FRC's Ethical Standard specifies the ethical requirements of auditors in both the private and the public sectors. All of the national audit agencies in the UK have agreed to adopt the principles contained in the Ethical Standard. Compliance with that standard also represents compliance with the parts of the International Ethics Standards Board for Accountants' Code of Ethics for Accountants covering audit work that has been adopted by most UK accountancy institutes (see appendix 1) and therefore applicable to a significant number of Audit Scotland staff.
2. **The principles of the Ethical Standard shall apply to all our work as interpreted by this section of the Staff Handbook.** This section explains how certain requirements of the Ethical Standard are to be applied in Audit Scotland and, where a policy is explicitly required, sets out that policy. However, staff should be aware that this section only covers those requirements where application guidance is necessary; it does not cover all the requirements of the Standard – the [full standard](#) is available on ishare.
3. All staff are required to adhere to Audit Scotland's Code of Conduct which describes the high level characteristics of the behaviours expected. The Code also specifies in more detail the requirements in certain areas. Staff should read this section in conjunction with the sections of the Handbook on Code of Conduct and Counter Fraud Policy.
4. If staff are in any doubt about the application of the Ethical Standard in any particular circumstances they should discuss the issue with their line manager and, if there is still uncertainty, with the Assistant Auditor General (as Ethics Partner).
5. This section has been updated to reflect the revised Ethical Standard issued by the FRC, which came into effect on 17 June 2016. Should any part of the Ethical Standard be revised in the future prior to this section being consequently updated, the revisions shall come into force in line with their effective date.
6. The revised Ethical Standard is in two parts
 - Part A sets out the overarching principles of integrity, objectivity and independence, together with supporting ethical provisions. These establish a framework of ethical outcomes that are required to be met.
 - Part B sets out specific requirements relevant to certain circumstances that may arise which are designed to assist in meeting the ethical outcomes. The application guidance in this section principally addresses some of the specific requirements.

Section 1 – General requirements and guidance

7. Section 1 of the Ethical Standard sets out the general requirements for auditors to act with integrity, objectivity and independence and establishes some of the framework for compliance with other requirements.
8. In the private sector, auditors are required to consider threats to integrity, objectivity and independence before accepting an audit appointment. In the public sector many of the audit appointments are made under statute and it may not, on some occasions, be possible to avoid Audit Scotland staff being involved in an audit. In these circumstances the auditors involved consider whether the threats are of such significance that they require to be reported formally to the audited body, the Auditor General for Scotland or Accounts Commission, or to the Scottish Parliament. Any such report should be discussed in advance with the Ethics Partner.
9. The following guidance below each requirement from the standard explains how they are applied in Audit Scotland.

Compliance

Paragraph 1.1D The *firm* shall establish appropriate policies and procedures to ensure that its owners or shareholders, as well as the members of the administrative, management and supervisory bodies of the *firm*, or of an *affiliate firm*, do not intervene in the carrying-out of an *engagement* in any way which jeopardises the integrity, objectivity or independence of the *firm* or *covered persons*.

Paragraph 1.2D The *firm* shall establish appropriate and effective organisational and administrative arrangements:

- (a) that are designed to prevent, identify, eliminate or manage and disclose any threats to its independence;
- (b) for dealing with and recording incidents which have, or may have, serious consequences for the integrity of its audit or other public interest assurance activities.

Application to Audit Scotland

10. All Audit Scotland staff shall
 - comply with the Code of Conduct and the further guidance in this section of the Staff Handbook
 - when working on audits, notify any potential conflicts of interest to their business group's Compliance Partner (i.e. Director of Audit Services or Director of Performance Audit and Best Value)
 - make an annual declaration of compliance with the Code of Conduct through the Fit and Proper self-assessment form.

Ethics Partner

Paragraph 1.12 The senior management of the firm shall designate a partner in the firm possessing the necessary seniority, relevant experience, authority and leadership levels (the 'Ethics Partner') as having responsibility for ensuring the firm's compliance with supporting ethical provision 1.1.

Application to Audit Scotland

11. The Assistant Auditor General has been designated as having the role of the Ethics Partner.

Threats to Integrity, Objectivity and Independence

Paragraph 1.28 When complying with supporting ethical provisions 2.1D - 2.3D, conditions and relationship that could give rise to threats to the integrity, objectivity or independence of the *firm* or *covered persons* are communicated to the appropriate person, having regard to the nature of the threats and to the part of the *firm* and the identity of any person involved.

Application to Audit Scotland

12. Audit Scotland policy is that all threats to integrity, objectivity or perceived loss of independence shall be reported to the Compliance Partner for the business group in which the relevant member of staff works or to the Ethics Partner. This requirement applies to all types of audit work.

Supporting ethical provision 2.1D The *firm* and each *covered person*, shall ensure that the independence of the *firm* and each *covered person* is not compromised with respect to each *entity relevant to the engagement*. This includes ensuring that the *firm* and each *covered person* is not involved in the decision-taking of any such entity.

Application to Audit Scotland

13. Audit Scotland policy is that staff shall not take decisions that are the responsibility of management of the audited body or its affiliates.

Paragraph 1.33 The *firm* shall establish policies and procedures to require the *engagement partner* to identify and assess the significance of threats to the integrity and objectivity of the *firm* and *covered persons* on an individual and cumulative basis, including any threats that may compromise independence:

- (a) when considering whether to accept or retain an *engagement*;**
- (b) when planning the *engagement*;**
- (c) when forming an opinion and signing the report on the financial statements or other *subject matter information*;**
- (d) when considering whether to accept or continue to provide *non-audit / additional services* to an *engagement* by the *firm*; and**
- (e) when potential threats are reported to him or her.**

Application to Audit Scotland

14. Audit appointments are made by the Auditor General or Accounts Commission based on advice from Audit Strategy, so the risk to independence in relation to accepting audits does not apply. There is therefore no need to identify threats to objectivity, including perceived loss of independence when considering whether to accept or retain an audit appointment.
15. For agreement audits, audit staff should document any threats to integrity, independence and objectivity and should consult Audit Strategy before initial acceptance of the engagement.
16. Audit Scotland only provides audit and audit-related services to audited bodies. Occasionally auditors may be asked to undertake non-audit work for their audited bodies; any such requests must obtain approval from the Ethics Partner before any work is agreed as stated in the letters of appointment.

Identification and Assessment of Safeguards

Paragraph 1.49 The *firm* shall establish policies and procedures which set out the circumstances in which those additional requirements listed in paragraph 1.48 that apply to *public interest entities* or to *listed entities* or both are applied to other *engagements*.

Application to Audit Scotland

17. Audit Scotland treats the audits of bodies where the auditor remuneration is greater than £300,000 as if they were listed companies to which the requirements of paragraph 1.49 apply.
18. There is one public interest entity which is currently audited by a private firm.

Engagement Quality Control Review

Paragraph 1.56 Requirements for engagement quality control review are established in ISQC (UK) 1 (Revised June 2016).

Application to Audit Scotland

19. The requirement for an engagement quality control review applies to all bodies with an auditor remuneration greater than £300,000. It also includes any bodies which meet the risk based criteria established by Audit Services Group (ASG), i.e. a high degree of risk is present and/or previous or anticipated qualified opinions on the financial statements occur. On these audits, a peer review shall take place.

Overall Conclusion

Paragraph 1.57 At the end of the *engagement* process, when forming an opinion to be reported, or otherwise reporting on the work undertaken, but before issuing the report, the *engagement partner* shall reach an overall conclusion that any threats to integrity or objectivity including any that could impair independence on an individual and cumulative basis have been properly addressed in accordance with this Ethical Standard. If the *engagement partner* cannot make such a conclusion, he or she shall not report and the firm shall resign or otherwise withdraw from the engagement unless not permitted to do so by law or regulation.

Application to Audit Scotland

20. If the engagement lead on an audit appointment is unable to conclude that any threats to integrity, objectivity and independence have been addressed in accordance with the Ethical Standard, the matter shall be brought to the attention of the relevant Compliance Partner and/or to the Ethics Partner for resolution.

Communication with Those Charged With Governance

Paragraph 1.61 The *engagement partner* shall ensure that those charged with governance of each *entity relevant to an engagement*, and, in the case of an *investment circular reporting engagement*, any other persons or entities the *firm* is instructed to advise, are appropriately informed on a timely basis of all significant facts and matters that may bear upon the integrity, objectivity and independence of the *firm* or *covered persons*.

Application to Audit Scotland

21. The information required by paragraph 1.61 shall be communicated to those charged with governance via the annual audit plan, the annual audit report and other relevant communications.

Paragraph 1.66 In the case of *public interest entities*, and *listed entities*, relevant to an engagement other than an *investment circular reporting engagement*, the engagement partner shall ensure that the audit committee is provided with:

(a) a written disclosure of relationships (including the provision of *non-audit / additional services*) that may bear on the integrity, objectivity or independence of the *firm* or *covered persons*. This shall have regard to relationships with the entity, its directors and senior management, its *affiliates*, and its *connected parties*, and the threats to integrity or objectivity, including those that could compromise independence, that these create. It shall also detail any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable the integrity, objectivity and independence of the *firm* and each *covered person* to be assessed;

(b) details of *non-audit / additional services* provided and the fees charged in relation thereto;

(c) written confirmation that the *firm* and each *covered person* is independent;

(d) details of any inconsistencies between this Ethical Standard and the policy of the *entity* for the provision of *non-audit / additional services* by the *firm* and any apparent breach of that policy.

(e) an opportunity to discuss independence issues.

Application to Audit Scotland

22. The requirements of paragraph 1.66 apply to all bodies where the auditor remuneration is greater than £300,000.
23. For all other bodies, paragraph 1.61 describes the general requirements that apply relating to communication with those charged with governance. These will generally include the key elements of the audit engagement partner's consideration of integrity, objectivity and independence, such as:
- the principal threats, if any, to integrity or objectivity including any that could impair independence identified by audit staff, including consideration of all relationships between the audited body, its affiliates and directors, and Audit Scotland;
 - any safeguards adopted and the reasons why they are considered to be effective, including any independent partner review;
 - the overall assessment of threats and safeguards;
 - information about the general policies and processes within Audit Scotland for maintaining integrity, objectivity and independence.

Section 2 – Financial, Business, Employment and Personal Relationships

24. This section of the Ethical Standard sets out the requirements concerning relationships with audited bodies including transfers of staff in either direction.
25. The requirements covering financial or business interests in audited bodies shall be considered by Compliance Partners and, where necessary, the Ethics Partner via the Fit and Proper self-assessment process.
26. The following guidance below each requirement from the standard explains how they are applied in Audit Scotland. The requirements relate to loans, employment, secondments and staff joining or leaving Audit Scotland from or to a public sector body in Scotland.
27. Where a member of staff of Audit Scotland has left to join an audited body in a senior position, particularly as chief executive or finance director or equivalent, there remains a threat to the conduct of future audits especially where the member of staff leaving had management responsibility for members of the audit team. These threats and how Audit Scotland manages them are detailed below.

Financial considerations

Paragraph 2.4D *The firm, each of the firm's key audit partners and each of the firm's directly involved covered persons for any engagement other than an investment circular reporting engagement, and any persons closely associated with the firm or any such partner or covered person, shall not:*

(a) hold any material *financial interest* (other than an indirect financial interest held through a diversified collective investment scheme) in, or engage in any transaction in, any *financial instrument* of any *entity relevant to an engagement* in the *area of activity* in which they (or in the case of a *person closely associated*, the *area of activity* in which the *firm, key audit partner* or *covered person* with whom they are closely associated) are involved relating to *engagements* other than *investment circular reporting engagements*; or

(b) hold any financial interest, other than an indirect financial interest held through a diversified collective investment scheme, in:

(i) any *entity relevant to an engagement* other than an *investment circular reporting engagement* for which they are a *directly involved covered person*; or

(ii) an entity which is an *affiliate* of such an entity; or

(iii) any other entity otherwise related to such an entity in circumstances where holding such a financial interest may cause, or may be generally perceived as causing, a conflict of interest; or, if a person holds such a financial interest they shall be excluded from any role by virtue of which they would be a covered person for any such engagement.

Application to Audit Scotland

28. Audit Scotland staff shall not hold a financial interest in a financial instrument issued by any body where the auditor is appointed by the Auditor General or Accounts Commission or.

Loans and Guarantees

Paragraph 2.26 Loans by an entity relevant to an engagement that is a bank or similar institution to a covered person, or to persons closely associated with them (for example, home mortgages, bank overdrafts or car loans), do not create an unacceptable threat to integrity or objectivity that compromises independence, provided that normal business terms apply. However, where such loans are in arrears by a significant amount, this creates an intimidation threat that compromises independence.

Application to Audit Scotland

29. Where a member of staff or their household is in arrears with council tax, especially if an arrestment of earnings order has been made, they shall notify their line manager immediately and shall take no further part in any audit work involving that council until the outstanding debt has been repaid.

Management Role with an Entity Relevant to an Engagement

Paragraph 2.38 A *firm* shall not admit to the partnership, or employ a person in a position as a *covered person*, if that person is also employed by any *entity relevant to the engagement*, or by any *affiliate* of such an entity ('dual employment').

Application to Audit Scotland

30. Audit Scotland shall not employ as financial audit staff individuals who are also employed by an audited body.
31. Staff may be employed to work on other audit work, such as national performance audits, provided that the work is not focussed on their other employer. For example, a Best Value audit of the employee's council would not be acceptable.
32. Any incidental work relating to the other employer (e.g. preparing a report from a national survey which includes the other employer) shall be subject to specific review by another member of staff.

Loan Staff Assignments

Paragraph 2.39 A *firm* shall not enter into an agreement with an *entity relevant to an engagement* other than an *investment circular reporting engagement*, or with the *affiliates* of such an entity, or otherwise, to provide any partner or employee ('loan staff') to work for a temporary period as if that individual were an employee of any such entity or its affiliates (a 'loan staff assignment') unless

(a) the agreement is for a short period of time and does not involve employees or partners performing *non-audit / additional services* that would not be permitted under this Ethical Standard; and

(b) the entity:

(i) agrees that any individual loan staff concerned will not hold a management position, will not be involved in the decision-taking of the entity and, in the case of an *audited entity* that is a *public interest entity*, will not play any part in the management of the entity; and

(ii) acknowledges its responsibility for directing and supervising the work to be performed, which will not include such matters as:

- making management decisions; or
- exercising discretionary authority to commit the entity to a particular position or accounting treatment

Paragraph 2.43 Where a partner or employee returns to the *firm* on completion of a loan staff assignment, that individual shall not be given any role on any *engagement* involving any function or activity that he or she performed or supervised during that assignment.

Application to Audit Scotland

33. The requirements at paragraphs 2.39 and 2.43 cover staff on secondment to audited bodies. Any such secondment shall be considered and planned in accordance with the principles in the secondment policy section of this handbook.
34. Although the Ethical Standard does not cover the secondment of staff from audited bodies to Audit Scotland, the same principles apply. Secondees to audit teams shall not work on the audit of the body from which they are seconded. Any departure from this policy, due to for example the previous role of the secondee, shall be agreed with the Ethics Partner.
35. Secondees to the Performance Audit and Best Value Group (PABV) may be used on national performance audits which involve coverage of their principal employer but they shall not audit/review work for which they were previously responsible and any work relating to their principal employer in which the secondee is involved shall be subject to review by a more senior member of staff.

Partners and Engagement Team Members Joining an Entity Relevant to an Engagement

Paragraph 2.47 *Firms* shall establish policies and procedures that require in relation to any *entity relevant to an engagement* in which an individual is, or was at any time over the previous year (two years in the case of a partner), directly involved:

(a) for all such *engagements*:

(i) senior members of the *engagement team* to notify the *firm* of any situation involving their potential employment with any such entity; and

(ii) other members of the *engagement team* to notify the *firm* of any situation involving their probable employment with any such entity;

(b) for an *engagement* other than an *investment circular reporting engagement*:

(i) all partners in the *firm* to notify the *firm* of any situation involving their potential employment with any such entity; and

(ii) any other employee of the *firm* and any other natural person whose services are placed at the disposal of or under the control of the *firm*, where such employee or other person is personally approved as a *statutory auditor* under relevant legislation within the European Union, to notify the *firm* of any situation involving their probable employment with any such entity;

(c) anyone who has given such notice to be removed from the *engagement team*; and

(d) a review of the *engagement* work performed by any resigning or former *engagement team* member in the current and, where appropriate, the most recent *engagement*.

Application to Audit Scotland

36. References to 'Partner' shall be defined as AD and above (Band 4 in the new banding structure).
37. Colleagues in Band 4 shall notify the Ethics Partner of any application for any job in a public body subject to audit by auditors appointed by the Auditor General or Accounts Commission. The Auditor General shall be notified of any application made by the Ethics Partner.
38. Staff in grades G (Band 3) and F (Band 2B) shall notify the Ethics Partner of any application to a relevant audited body.

39. 'Any entity relevant to an engagement' is defined as any body which they have audited in the previous 12 months.
40. All other members of staff not covered by the above shall notify the Ethics Partner of any job offer from a relevant audited body (as defined above).
41. For staff carrying out audit work at the specific body applied to, they shall not carry out any further work on the audit pending the outcome of the application/offer and, if successful, shall not return to that work. Staff who notify potential employment but are not in the event selected shall obtain their line manager's approval to return to the audit; such approval shall be provided whenever and wherever it is reasonable and practicable to do so.
42. All work carried out on any audit activity at the audited body by the resigning member of staff shall be reviewed.

Paragraph 2.53 Where a partner, or another person (including a person whose services are at the disposal or under the control of the *firm*) who is personally approved as a *statutory auditor* as described in paragraph 2.48, is appointed as a director (including as a non-executive director), a member of the audit committee or body performing equivalent functions, or to a *key management position* with an *entity relevant to an engagement*, having previously been a *covered person*:

(a) in the case of a partner, at any time during the two years prior to such appointment; or

(b) in the case of another person, at any time during the year prior to such appointment; the *firm* shall resign from the *engagement* where possible under applicable law or regulation. The *firm* shall not accept an other *engagement* for the entity until:

(i) in the case of a partner, a two-year period; or

(ii) in the case of another person, a one year period; commencing when the person ceased to be a *covered person*, has elapsed or until the person ceases employment with the entity, whichever is the sooner.

Application to Audit Scotland

43. Where an individual in Band 4 leaves Audit Scotland to join an audited body as a director or in a key management position and they carried out the role of audit engagement partner or other relevant partner role at that body, Audit Strategy shall normally make a recommendation to the Auditor General or Accounts Commission that the audit appointment shall be transferred to a firm.
44. If transfer to a firm is not possible (such as in the case of the Scottish Government or other audits where the Auditor General signs the independent auditor's report) stringent safeguards shall be put in place to ensure that there is no loss of independence, e.g. independent review by another director or a firm.
45. Where the member of staff carried out the engagement partner equivalent role on a Best Value audit of, or a national performance audit covering, the audited body, the composition of the financial audit team shall be reviewed by Audit Strategy in consultation with ASG. Audit Strategy shall take account of the role of the person leaving and the role they have assumed and make a recommendation to the Auditor General or Accounts Commission for
- no change; or
 - a change in the team; or
 - a change of appointed auditor.

46. Audit Strategy shall take the circumstances of the member of staff leaving into account if the next audit appointments are made within two years of the person leaving and shall normally not recommend reappointment of Audit Scotland within a two year period.
47. Where any other former member of the audit team of an audited body leaves Audit Scotland and within two years joins the audited body as a director or in a key management position the composition of the audit team shall be reviewed.

Employment with the Firm

Paragraph 2.65 Where a former director or a former employee of an *entity relevant to an engagement*, who was in a position to exert significant influence over the preparation of the financial statements or other *subject matter information* or *subject matter* of such an *engagement*, joins the *firm*, that individual shall be excluded from any role in which they would be a *covered person* relevant to that entity or its *affiliates* for a period of two years following the date of leaving the entity.

Application to Audit Scotland

48. For financial audits, paragraph 2.65 applies in full. If the individual joining Audit Scotland has ASG management responsibility they shall have no involvement in the audit of their former employer, and the audit shall be subject to an independent review for the first two years irrespective of the size of the body.
49. An individual joining PABV from a management position shall not have any involvement in audit work or studies which focus on their former employer for a period of two years after joining. Any incidental work shall be subject to specific review by another member of staff.

Family Members Employed by an Entity Relevant to an Engagement

Paragraph 2.59 Where a covered person, or any partner in the firm, becomes aware that a person closely associated with them, or a close family member who is not a person closely associated with them, is employed by an entity relevant to the engagement and that person is in a position to exercise influence on the accounting records or financial statements or other subject matter information or subject matter of such an engagement, that covered person or that partner shall either:

(a) in the case of a person closely associated with them being employed by the entity in such a position, be excluded from any role in which they would be a covered person; or

(b) in the case of a close family member of a covered person who is not a person closely associated with them, or, for an engagement other than an *investment circular reporting engagement*, any close family member of any partner in the *firm* who is not a person closely associated with them, report the matter to the *engagement partner* to take appropriate action. If it is a *close family member* of the *engagement partner* or if the *engagement partner* is in doubt as to the action to be taken, the *engagement partner* shall resolve the matter in consultation with the *Ethics Partner/Function*.

Application to Audit Scotland

50. A number of Audit Scotland staff have members of their family who are employed by public bodies. Given the wide range of circumstances that may exist, each case shall be dealt with on its merits. However, the general policy is that the closer to the subject matter of audit work that the family member is employed (e.g. in a finance role), the more likely it is that the member of staff should not take part in the audit. Similarly the more senior the member of staff and/or their family member, the greater the perceived threat to independence and objectivity.
51. It is unlikely that family members employed in roles such as teachers, doctors or nurses would normally create any threat to independence of staff members.

52. Staff engaged on audit work that covers a number of audited bodies need to be particularly vigilant in this area. Members of staff shall discuss any such relationships with their line manager and if appropriate the Compliance and/or Ethics Partner.

Family and Other Personal Relationships

Paragraph 2.70 The *firm* shall establish policies and procedures that require:

(a) partners and professional *staff* members to report to the *firm* any *persons closely associated* with them, any *close family* who are not a *person closely associated with them*, and other personal relationships, where any of those persons is involved with an *entity relevant to an engagement* of the *firm*, where the partner or professional *staff* member considers that the relationship might create a threat to integrity or objectivity or may compromise independence;

(b) the relevant *engagement partners* to be notified promptly of any information reported by partners and other professional *staff* members as required by paragraph **(a)**.

Application to Audit Scotland

53. All staff shall complete an annual Fit and Proper self-assessment form. This requires staff to immediately report circumstances that would negatively impinge on their independence to their line manager and where necessary to their Compliance Partner.

Governance Role with an Entity Relevant to an Engagement

Paragraph 2.61 The *firm* or a partner or member of staff of the *firm* shall not accept appointment or perform a role:

(a) as an officer or member of the board of directors of an entity relevant to an engagement of the *firm*;

(b) as a member of any subcommittee of that board; or

(c) in such a position in an entity which holds directly or indirectly more than 20% of the voting rights in the entity relevant to an engagement, or in an entity in which the entity relevant to such an engagement holds directly or indirectly more than 20% of the voting rights.

Application to Audit Scotland

54. Audit Scotland encourages members of staff to take part in voluntary and community bodies, many of which receive substantial public funding. In taking on such roles staff need to be aware of the potential for their position to be perceived as creating a conflict of interest which may impair their integrity, independence or objectivity. Staff shall discuss any such roles with their line manager and each case will be considered on its merits. The following examples may help:

- Example 1 – an engagement lead on the audit of a council is offered the role of treasurer or chair to a Citizens' Advice Bureau which is 80% funded by that council and the funding is discretionary. This could create a perception of a conflict between the roles and should be avoided.
- Example 2 – membership of a school board – while the school will be funded by the council, it is required to provide education as a statutory service. The likely influence of a member of a school board on the level of funding is negligible and the potential for conflict of interest is minimal.

55. Staff should not seek board membership of bodies where the Auditor General or the Accounts Commission appoint the auditor as this can limit flexibility in making audit appointments or in the deployment of staff. Any offers for such positions shall be agreed with the Ethics Partner who may refer cases to the Management Team.

Section 3 – Long Association with Engagements and With Entities Relevant to Engagements

56. The following guidance below each requirement from the standard explains how they are applied in Audit Scotland.

General Requirements

Paragraph 3.1 The *firm* shall establish policies and procedures to monitor the length of time and extent of involvement that partners and *staff* in senior positions, including those from other disciplines, serve as members of the *engagement team(s)* for recurring *engagements* for particular entities.

Application to Audit Scotland

57. The length of time that staff work on a particular audit shall be monitored with a view to key senior staff not normally staying on the same audit for more than five years in the same role.

58. Business groups shall maintain a 'rotation' database for this purpose and staff must confirm they have updated this every year via the Fit and Proper form.

Key Audit Partners and Engagement Partners

Paragraph 3.11 In the case of listed entities, save where the circumstances contemplated in paragraph 3.14 and 3.15 apply, the firm shall establish policies and procedures to ensure in respect of a recurring engagement that:

- (a) no one shall act as engagement partner for more than five years; and
- (b) anyone who has acted as the engagement partner for a particular entity for a period of five years, shall not subsequently participate in the engagement until a further period of five years has elapsed.

Application to Audit Scotland

59. Paragraph 3.11 applies to all bodies where the auditor remuneration is greater than £300,000.

60. Any member of staff acting as engagement partner shall not do so for more than five years in the same role.

Engagement Quality Control Reviewers and Other Key Partners Involved in the Engagement

Paragraph 3.20 In the case of *public interest entities* and other *listed entities*, the *firm* shall establish policies and procedures to ensure in respect of a recurring *engagement* that:

- (a) no one shall act as the *engagement quality control reviewer* or a *key partner involved in the engagement* for a period longer than seven years;
- (b) where an *engagement quality control reviewer* or a *key partner involved in the engagement* becomes the *engagement partner*, the combined period of service in these positions shall not exceed seven years; and
- (c) anyone who has acted:
 - (i) as an *engagement quality control reviewer* for a particular entity for a period of seven years, whether continuously or in aggregate, shall not participate in the *engagement* until a further period of five years has elapsed;
 - (ii) as a *key partner involved in the engagement* for a particular entity for a period of seven years, whether continuously or in aggregate, shall not participate in the *engagement* until a further period of two years has elapsed;
 - (iii) in a combination of roles as:

the *engagement quality control reviewer*, a *key partner involved in the engagement*, or
 the *engagement partner* for a particular entity for a period of seven years, whether continuously or in aggregate, shall not participate in the *engagement* until a further period of five years has elapsed.

Application to Audit Scotland

61. Paragraph 3.20 applies to all bodies where the auditor remuneration is greater than £300,000.
62. In the case of the Scottish Government audit, where the audit opinion is signed by the Auditor General, the engagement lead is considered to be the Assistant Director, who is subject to the time limits.
63. The 'Key partner involved in the engagement' is an audit partner involved at group level and responsible for key decisions or judgements on significant matters such as on significant subsidiaries or divisions of the audited body or on significant risk factors that relate to that body.

Other Partners and Staff Involved in the Engagement in Senior Positions

Paragraph 3.21 In the case of *public interest entities* and other *listed entities*, the *engagement partner* shall review the safeguards put in place to address the threats to the objectivity and independence of the person or persons conducting the *engagement* arising where partners and *staff* have been involved in the *engagement* in senior positions for a continuous period longer than seven years and shall discuss those situations with the *engagement quality control reviewer*. Any unresolved problems or issues shall be referred to the Ethics Function / Partner.

Application to Audit Scotland

64. All staff shall normally be limited to five years on any one audit, except in exceptional circumstances where the limit may be extended by up to two years. Therefore the requirement of paragraph 3.21, which would otherwise apply to bodies where the auditor remuneration is greater than £300,000, does not apply to audits undertaken by ASG.

Section 4 – Fees, remuneration and evaluation policies, gifts and hospitality, litigation

65. The following guidance below each requirement from the standard explains how they are applied in Audit Scotland.

Fees

Paragraph 4.1 The engagement partner shall be satisfied and able to demonstrate that the engagement has assigned to it sufficient partners and staff with appropriate time and skill to perform the engagement in accordance with all applicable Engagement and Ethical Standards, irrespective of the engagement fee to be charged.

Application to Audit Scotland

66. Audit engagement leads shall assign sufficient staff with appropriate skills to allow the work to be carried out in accordance with applicable standards including the Audit Guide or Project Management Framework as appropriate, irrespective of the audit fee, budget or planned timetable.

Paragraph 4.6R Fees for the provision of engagements shall not be contingent fees.

Application to Audit Scotland

67. Audit Scotland does not undertake any non-audit work on a contingent fee basis for audited bodies.

Paragraph 4.25 In the case of public interest entities and of other listed entities relevant to an engagement, the engagement partner shall disclose to the audit committee, in writing, any contingent fee arrangements for non-audit / additional services provided by the firm or its network firms.

Application to Audit Scotland

68. As Audit Scotland does not undertake any non-audit work on a contingent fee basis, paragraph 4.25 does not apply.

Paragraph 4.42 Where it is expected that the total fees for services receivable from a public interest entity or other listed entity and its subsidiaries relevant to a recurring engagement by the firm will regularly exceed 10% of the annual fee income of the firm or, where profits are not shared on a firm-wide basis, of the part of the firm by reference to which the engagement partner's profit share is calculated, the firm shall not act as the provider of the engagement for that entity and shall either resign or not stand for reappointment, as appropriate.

Application to Audit Scotland

69. The Scottish Government group of audits is the only audit which normally has fees exceeding 10% of ASG's total fee income. However, each subsidiary is audited independently and the engagement lead for the consolidated account has no direct influence, in that role, over the audit judgements for the subsidiaries.

70. The threats to objectivity envisaged by the standard are fully mitigated where the audit appointment is made independently of the body (such as by the Auditor General or Accounts Commission) and consequently this requirement does not apply.

Paragraph 4.47 Where it is expected that the total fees services receivable from a public interest entity or other listed entity and its subsidiaries relevant to a recurring engagement by the firm will regularly exceed 5% of the annual fee income of the firm or the part of the firm by reference to which the engagement partner's profit share is

calculated, but will not regularly exceed 10%, the engagement partner shall disclose that expectation to the Ethics Partner/Function and to those charged with governance of the entity, including the audit committee where there is one, and discusses with both the threat to integrity, objectivity and independence of the firm and covered persons and whether safeguards need to be applied to eliminate or reduce the threat to a level where independence would not be compromised.

Application to Audit Scotland

71. The fees receivable from the audits of the Scottish Government and Glasgow City Council are each above 5% of the total annual audit fee. However, as previously noted, the threats to objectivity envisaged by the standard do not arise because the audit appointment is made independently of those bodies.

Paragraph 4.51 Where it is expected that the total fees for services receivable from a non-listed entity, that is not a public interest entity, and its subsidiaries relevant to a recurring engagement will regularly exceed 10% of the annual fee income of the firm or the part of the firm by reference to which the engagement partner's profit share is calculated, but will not regularly exceed 15%, the engagement partner shall disclose that expectation to the Ethics Partner/Function and to those charged with governance of the entity and the firm shall arrange an external independent quality control review of the engagement to be undertaken before the firm's report is finalised.

Application to Audit Scotland

72. The Scottish Government group of audits normally has fees exceeding 10% of ASG's total fee income. However, each subsidiary is audited independently and the engagement lead for the consolidated account has no direct influence, in that role, over the audit work or judgements for the subsidiaries. As previously noted, the threats to objectivity envisaged by the standard do not arise where the audit appointment is made independently.

Remuneration and Evaluation Policies

Paragraph 4.57 The firm shall establish policies and procedures to ensure that each of the following is true in relation to each entity relevant to an engagement by the firm:

- (a)** a primary criterion for evaluating the performance or promotion of members of the engagement team is how they have contributed to the quality of engagements undertaken;
- (b)** the objectives of the members of the engagement team do not include selling non-audit / additional services to the entity;
- (c)** the criteria for evaluating the performance or promotion of members of the engagement team do not include success in selling non-audit / additional services to the entity; and
- (d)** no specific element of the remuneration of a member of the engagement team is based on his or her success in selling non-audit / additional services to the entity.

Application to Audit Scotland

73. The selling of non-audit work is not a feature of either performance appraisal or staff remuneration.

Gifts and Hospitality

Paragraph 4.61D A firm, its partners and any covered person, and persons closely associated with them, shall not solicit or accept pecuniary and non-pecuniary gifts or favours, including hospitality, from an entity relevant to the engagement, or any other entity related to that entity, unless an objective, reasonable and informed third party would consider the value thereof as trivial or inconsequential.

Paragraph 4.63 The firm shall establish policies on the nature and value of gifts, favours and hospitality that may be accepted from and offered to an entity relevant to an engagement, or any other entity related to that entity, their directors, officers and employees, and shall issue guidance to assist partners and staff to comply with such policies.

Application to Audit Scotland

74. Audit Scotland's gift and hospitality policy is set out in the Code of Conduct. All staff must confirm compliance with this via the annual Fit and Proper self-assessment form.

Section 5 – Non-audit / Additional services provided to audited entities

75. Paragraphs 5.3 to 5.39 of section 5 set out the general approach in relation to the provision of non-audit services to audited bodies, and additional services to bodies which they may not audit but for which they undertake other public interest assurance services. This approach is applicable irrespective of the nature of the non-audit / additional services in a given case.
76. Paragraphs 5.44 to 5.164 of section 5 illustrate the application of the general approach to a number of common non-audit / additional services.
77. The following guidance below each requirement from the standard explains how they are applied in Audit Scotland.

General Approach to Non-audit / Additional Services

Paragraph 5.11 The firm shall establish policies and procedures that require others within the firm, when considering whether to provide a non-audit / additional service to an entity relevant to an engagement, other than an investment circular reporting engagement, or to any of its affiliates, to communicate details of the proposed non-audit / additional service to the engagement partner.

Application to Audit Scotland

78. All proposed non-audit work must be approved by Audit Strategy as per the policy statement in appendix 1 of the Annual Audit Planning Guidance.
79. Any non-audit work carried out by ASG shall be arranged through the audit engagement lead.
80. While it is unlikely that work carried out at an audited body by PABV or work carried out by any other member of staff would constitute work which might threaten an auditor's independence or objectivity, all staff need to be aware of the possibility in relation to any improvement work or advice and shall discuss any proposed work with the audit engagement lead.
81. Audit Scotland staff do not provide additional services to bodies that are not audited.

Evaluation of Specific Non-audit Services and Additional Services

Paragraphs 5.48 to 5.164 gives the following examples of non-audit services where extreme care is required: Internal audit services; Information technology services; Valuation services; Actuarial valuation services; Tax services; Litigation support services; Legal services; Recruitment and remuneration services; Corporate finance services; Transaction related services; Restructuring services; and Accounting Services.

Application to Audit Scotland

82. Paragraphs 5.67 (Valuation services), 5.74 (Actuarial valuation services), 5.83 (Tax services), 5.104 (Litigation services), 5.109 (recruitment and remuneration services) and 5.155 (Accounting services) apply to all bodies with an auditor remuneration greater than £300,000.
83. Transaction related services: preliminary opinions on the likely accounting treatment of PFI/PPP schemes may be undertaken by the audit team but any undue attempts by management to put pressure on the auditor to reach a particular view shall immediately be reported to the Ethics Partner.

Audit Related Services

Paragraph 5.41 Audit related services are: Reporting required by law or regulation to be provided by the auditor; Reviews of interim financial information; Reporting on regulatory returns; Reporting to a regulator on client assets; Reporting on government grants; and Reporting on internal financial controls when required by law or regulation; Extended audit work that is authorised by those charged with governance performed on financial information and/or financial controls where this work is integrated with the audit work and is performed on the same principal terms and conditions.

Application to Audit Scotland

84. Audit related services are those non-audit services that are largely carried out by the engagement team and where the work involved is closely related to the financial audit.
85. **Each type of audit related services may be undertaken.** The type of audit related service most likely to be undertaken is work on the certification of grant claims.

APPLICATION OF IESBA ETHICS CODE TO UK ACCOUNTANCY BODIES

The International Ethics Standards Board for Accountants (IESBA) develops ethical standards and guidance for use by professional accountants. The IESBA Code issued in July 2009 serves as the foundation for codes of ethics developed and enforced by members of the International Federation of Accountants (IFAC). No member body of IFAC or firm issuing reports in accordance with International Auditing and Assurance Standards is allowed to apply less stringent standards than those stated in the IESBA Code.

Each professional institute in the UK adopted the IESBA Code as the basis for their own ethics codes from 1 January 2011. Members are required to comply with their institute's code.

Information on each institute's ethics code is as follows

- CIPFA has a [Standard of Professional Practice on Ethics](#) (SOPP on Ethics).
- ICAS has a [Code of Ethics](#).
- The ACCA [Rulebook](#) contains the Code of Ethics and Conduct at section 3.
- ICAEW has a [Code of Ethics](#).