



# Independence Standard

Version 1.3

Certified General Accountants Association of Canada  
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## DEFINITIONS

### “Assurance client”

An entity in respect of which, a firm conducts an assurance engagement.

### “Assurance engagement”

An engagement defined by the recommendations and generally accepted standards for assurance engagements contained in the CICA Handbook - Assurance. Where, pursuant to an accountability relationship between two or more parties, a practitioner is engaged to issue a written communication expressing a conclusion concerning a subject matter for which the accountable party is responsible.

### “Assurance team”

- a) All professional colleagues participating in the assurance engagement;
- b) All others within a firm who can directly influence the outcome of the assurance engagement, including:
  - (i) those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement, including for the purposes of an audit engagement those at all successively senior levels above the lead engagement partner through to the firm’s chief executive;
  - (ii) those who provide consultation regarding technical or industry-specific issues, transactions or events for the assurance engagement;
  - (iii) those who provide quality control for the assurance engagement; and
- c) For the purpose of an audit client, all those within a network firm who can directly influence the outcome of an audit engagement.

### “Audit client”

An entity in respect of which, a firm conducts an audit engagement. When the audit client is a reporting issuer, the audit client will always include its related entities.

### “Audit engagement”

An assurance engagement as defined by the recommendations of standards for audit engagements as contained in the CICA Handbook - Assurance, where there is an accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria.

### “Close relative”

Consists of a member’s non-dependent children, stepchildren, brothers, brothers-in-law, sisters, sisters-in-law, grandparents, grandchildren, parents, parents-in-law, and their respective spouses or spousal equivalents.

**“Direct financial interest”**

A financial interest that is:

- a) owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others);
- b) beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control; or
- c) owned through an investment club or private mutual fund in which the individual participates in the investment decisions.

**“Financial interest”**

An interest in equity or other security, debenture, loan, or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

**“Firm”**

A proprietorship, partnership, limited liability partnership, professional corporation, or a corporation engaged in the practice of public accounting.

**“Fund Manager”**

With respect to a mutual fund, an entity that is responsible for investing the mutual fund’s assets, managing its portfolio trading and providing it with administrative and other services, pursuant to a management contract.

**“Immediate family”**

Consists of a member’s spouse or spousal equivalent, whether or not dependent, and persons, whether or not related, who are dependent on the member or the member’s spouse or spousal equivalent.

**“Indirect financial interest”**

A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control.

**“Member”**

An individual who holds a Certified General Accountant designation and is in good standing. Where applicable, the term includes duly registered CGA students.

**“Mutual Fund”**

A mutual fund that is a reporting issuer under the applicable Canadian provincial or territorial securities legislation.

**“Network firm”**

An entity under common control, ownership or management within the firm or any entity that a reasonable and informed third party, having knowledge of all relevant information, would reasonably conclude as being part of the firm nationally or internationally.

**“Professional colleague”**

An accountant recognized by statutory authority.

**“Related entity”**

An entity that has any of the following relationships with the client:

- a) direct or indirect control over the client provided the client is material to such entity;
- b) a direct financial interest in the client provided such entity has significant influence over the client and the interest in the client is material to such entity;
- c) the client has direct or indirect control over the entity;
- d) an entity in which the client, or a related entity as described in c), has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity as described in c); or
- e) an entity that is under common control with the client (hereinafter a “sister entity”) provided the sister entity and the client are both material to the entity that controls both the client and sister entity.

In the case of a reporting issuer that is a mutual fund, the term related entity is limited to any entity that is:

- (a) the fund manager of the mutual fund; and
- (b) another mutual fund that has the same fund manager as the mutual fund and that is audited by the same firm or a network firm.

**“Reporting issuer”**

An entity that is deemed to be a reporting issuer under the applicable Canadian provincial or territorial securities legislation, other than an entity that has, in respect of a particular fiscal year, a market capitalization or total assets that are each less than \$10,000,000. An entity that becomes a reporting issuer by virtue of the market capitalization or total assets becoming \$10,000,000 or more in respect of a particular fiscal year will be considered to be a reporting issuer thence forward unless and until the entity ceases to have its shares, units or debt quoted, listed or marketed in connection with a recognized stock exchange or the entity has remained under the market capitalization threshold for a period of two years.

In the case of a period in which an entity makes a public offering:

- (a) the term “market capitalization” shall be read as referring to the market price of all outstanding listed securities and publicly traded debt measured during the closing price on the day of the public offering; and
- (b) the term “total assets” shall be read as referring to the amount of total assets presented on the most recent financial statements prepared in accordance with generally accepted accounting principles included in the public offering document.

In the case of a reporting issuer that does not have listed securities or publicly traded debt, the definition of reporting issuer shall be read without reference to market capitalization

**“Review client”**

An entity in respect of which, a member or firm conducts a review engagement. When the review client is a reporting issuer, the review client will always include its related entities.

**“Review engagement”**

An assurance engagement defined by the recommendations and generally accepted standards for review engagements of the CICA Handbook – Assurance where there is enquiry, analytical procedures and discussion relating to information supplied by the review client with the limited objective of assessing whether the information being reported on is plausible within the framework of appropriate criteria.

**“Specified auditing procedures engagement”**

An engagement defined by the recommendations of the CICA Handbook - Assurance that is designed to apply procedures to assess the accuracy of financial information supplied by the client, but not with the intent of expressing an audit opinion or providing negative assurance on the financial information.

**“Staff”**

An individual or entity employed or engaged under contract by the firm to provide services that might otherwise be provided by a partner or professional employee of a firm and includes partners.

## 1. INTRODUCTION

- 1.1 It is in the public interest that members, firms and members of assurance teams be independent of assurance clients. This independence is necessary in order to provide a reasonable level of assurance that any engagement conducted and subsequent report issued is grounded on professional judgment that is free of conflict of interest or bias.
- 1.2 This requirement for independence in assurance and specified auditing procedures engagements is formally set out in the CGA-Canada *Code of Ethical Principles and Rules of Conduct, (CEPROC)* “Trust and Duties” and rule R202 of which this Standard forms an integral component. Rule R202.1 requires that a member shall be free of any influence, interest or relationship in respect of the client’s affairs which impairs the member’s professional judgment or objectivity, or which, in the view of a reasonable observer may have that effect. Paragraph (a) of rule R202.1 prohibits a member from issuing a communication in assurance or specified auditing procedures engagements unless the member has considered and either reduced to an acceptable level or eliminated any threats to the member’s independence.
- This requirement creates an ongoing obligation for members, firms and members of assurance teams to identify and evaluate circumstances and relationships that create threats to independence and to take appropriate action to eliminate these threats or reduce them to an acceptable level by the application of safeguards. Furthermore, paragraph (c) of rule R202.1 obligates a member to ensure that staff of the firm is in compliance with these independence requirements.
- 1.3 This Standard provides members, members of assurance teams, firms and network firms with a conceptual framework for identifying, evaluating and responding to threats to independence.
- 1.4 This Standard makes use of the conceptual framework contained in the International Federation of Accountants *Code of Ethics for Professional Accountants*.

### *A Conceptual Approach to Independence*

- 1.5 Independence requires:
- a) Independence of mind:  
The state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity and exercise objectivity and professional scepticism;  
and
  - b) Independence in appearance:  
The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a member, firm or member of the assurance team’s integrity, objectivity or professional scepticism had been compromised.
- 1.6 In the context of this Standard, the word “independence” should not be construed to mean that a person exercising professional judgment ought to be free from all economic, financial and other relationships. This is impossible, as every member of society has relationships with others. Rather, it requires the significance of economic, financial and other relationships be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

- 1.7 Many different circumstances and relationships may be relevant in determining independence. Accordingly, it is impossible to define every situation that creates threats to independence and specify the appropriate safeguard that should be applied. Moreover, the nature of assurance engagements may differ and consequently different threats may exist, requiring the application of different safeguards. A conceptual approach that requires members, firms and members of assurance teams to identify, evaluate and address threats to independence based on a framework is therefore required.

## 2. FRAMEWORK FOR ASSESSING INDEPENDENCE

- 2.1 In accordance with CEPROC rule R202.1, this Standard provides a framework that members, members of assurance teams, firms and, where required, network firms, must use to:
- a) identify threats to independence;
  - b) evaluate whether these threats, considered individually and collectively, are clearly insignificant; and
  - c) in cases where the threats are not clearly insignificant, identify and apply safeguards to eliminate or reduce the threats to an acceptable level, such that independence of mind and independence in appearance are not compromised.
- 2.2 In cases where no safeguards are available to reduce the threat to an acceptable level, the only possible actions are to eliminate the activities or interest creating the threat, or to decline to accept or continue the assurance engagement. It is not possible to identify all such cases. However, there are specific circumstances identified in this Standard that result in such a case. Those identified are denoted in *italics* and constitute a specified prohibition which must be complied with in accordance with CEPROC rule R202.1(b).
- 2.3 Under this Standard, members, firms and members of assurance teams are obligated to identify and evaluate circumstances and relationships that create threats to independence. This obligation includes identifying and evaluating relationships between the member, firm, network firms or members of the assurance team and the assurance client. In addition, consideration should be given to whether relationships between individuals outside of the assurance team and the assurance client create threats to independence.

### *Consideration of Type of Engagement*

- 2.4 This Standard applies to all assurance and specified auditing procedures engagements. The nature of the threats to independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level will differ depending on the characteristics of the individual engagement. Therefore, the evaluation of relevant circumstances must include consideration of whether the assurance engagement is an audit or review engagement or another type of engagement, and in the case of an assurance engagement that is not an audit or review engagement, the purpose, subject matter and intended users of the report issued as a result of that engagement.
- 2.5 Audit and review engagements provide assurance to a wide range of potential users. Accordingly, for audit and review clients, the member, members of the assurance team, the firm and network firms are required to be independent of the client.
- 2.6 For assurance engagements where the client is not an audit or review client and the engagement is not expressly restricted for use by identified users, the member, assurance team and firm are required to be independent of the client. In addition, in the case of these

- engagements, consideration should be given to any threats that the member or firm has reason to believe may be created by network firm interests and relationships.
- 2.7 For assurance engagements where the client is not an audit or review client and the engagement is expressly restricted for use by identified users, the users are considered to be knowledgeable as to the purpose, subject matter and limitations of that report through their participation in establishing the nature and scope of the member's or firm's instructions to deliver the services, including the criteria by which the subject matter is to be evaluated. This knowledge and enhanced ability of the member or firm to communicate with all users of the report increases the effectiveness of safeguards to independence in appearance. These circumstances may be taken into account by the member or firm in evaluating the threats to independence and considering the applicable safeguards necessary to eliminate threats or reduce them to an acceptable level.
- 2.8 At a minimum, it will be necessary to apply the provisions of this Standard when evaluating the independence of the member, the firm or members of the assurance team and their immediate family and close relatives. Further, if the member, firm or member of the assurance team has a material financial interest in the client, whether direct or indirect, the self-interest threat created would be so significant no safeguard could reduce that threat to an acceptable level. Limited consideration of any threats created by network firm interests and relationships may be sufficient.
- 2.9 In summary, paragraphs 2.4 to 2.7 establish the following requirements:
- for an assurance engagement provided to an audit or review client, the member, members of the assurance team, the firm and network firms are required to be independent of the client;
  - for an assurance engagement provided to a client that is not an audit or review client, when the report is not expressly restricted for use by identified users, the member, members of the assurance team and firm are required to be independent of the client; and
  - for an assurance engagement provided to a client that is not an audit or review client, when the assurance report is expressly restricted for use by identified users, the member and members of the assurance team are required to be independent of the client. In addition, the firm must not have a material direct or indirect financial interest in the client.

#### *Consideration of Degree of Public Interest*

- 2.10 An evaluation of the significance of any threats to independence and the safeguards necessary to reduce those threats to an acceptable level must also take into account the degree of public interest in the assurance engagement. Certain entities hold a greater degree of public interest because, as a result of their business, their size or corporate status, they have a wide range of stakeholders. Examples of such entities might include listed companies, credit institutions, insurance companies and pension funds. Due to the high degree of public interest in the financial statements of these types of entities, certain paragraphs of this Standard deal specifically with matters relevant to the audit of these entities because of their public stature and the need to protect a large group of individuals, corporate or government interests.

#### *Other Considerations*

- 2.11 Paragraphs 2.18 to 2.23 of this Standard identify threats to independence. Paragraphs 2.24 to 2.32 analyze the safeguards capable of eliminating these threats or reducing them to an acceptable level. The threats and safeguards in this Standard are generally discussed in the

- context of interests or relationships between the member, firm, network firm, members of the assurance team and the assurance client. In certain cases the interest and relationships should be extended as follows:
- a) where an audit client is a reporting issuer, the member, firm and network firm are required to further consider the interests and relationships that involve the client's related entities and specific prohibitions are extended to the related entities;
  - b) for all other assurance clients, when the assurance team has reason to believe that a related entity of such an assurance client is relevant to the evaluation of the members or firm's independence, the member or the assurance team should consider that related entity when evaluating independence and applying appropriate safeguards; and
  - c) in the case of an audit or review client, the prohibitions with respect to financial interests are extended to related entities of the client.
- 2.12 For interests and relationships that require consideration, independence assessment should be completed in advance of accepting an assurance engagement. The evaluation of threats to independence, subsequent safeguards and whether a particular staff person will be a member of the assurance team should be supported by evidence obtained before deciding whether it is appropriate to accept an engagement.
- 2.13 The evaluation should be ongoing while the engagement is being performed to determine if the engagement should be continued. The obligation to make such an evaluation and take action arises when a member, firm, network firm or a member of the assurance team knows, or could reasonably be expected to know, of circumstances or relationships that might compromise independence.
- 2.14 There may be occasions when the member, a member of the assurance team, the firm or a network firm inadvertently violates the obligation to make such an evaluation. If such an inadvertent violation occurs it generally does not compromise independence with respect to an assurance client, provided the member or firm has appropriate policies and procedures in place to promote independence, and once discovered, the violation is corrected promptly and any necessary safeguards applied.
- 2.15 In accordance with CEPROC rule R202.1(d), when threats to independence that are not clearly insignificant are identified, and the member or firm decides to accept or continue the assurance engagement, the decision must be documented. The documentation must include a description of the threats identified and the safeguards applied to eliminate or reduce the threats to an acceptable level.
- 2.16 Throughout this Standard, reference is made to significant or clearly insignificant threats in the evaluation of independence. In considering the significance of any particular matter, qualitative as well as quantitative factors must be taken into account. A matter may be considered clearly insignificant only if it is deemed to be both trivial and inconsequential.
- 2.17 This Standard concludes with examples of how the conceptual approach to independence is applied to specific circumstances and relationships that may create threats to independence and considers how these threats can be eliminated or reduced to an acceptable level by the application of safeguards. In certain examples, the threats to independence are so significant the only possible actions are to eliminate the threat or decline to accept or continue the assurance engagement. The examples presented are intended to illustrate the application of this Standard but are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances that may create threats to independence. Consequently, it is not sufficient

for a member, firm, network firm, or member of an assurance team to comply with these examples; rather professional judgment must be used in applying this Standard to identify, evaluate, and eliminate or reduce to an acceptable level, threats to independence.

### ***Threats to Independence***

2.18 Independence is potentially affected by self-interest, self-review, advocacy, familiarity and intimidation threats.

2.19 A self-interest threat occurs when a member, firm or member of the assurance team could benefit from a financial interest in, or other self-interest conflict with, an assurance client.

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

- a) a direct financial interest or material indirect financial interest in an assurance client;
- b) a loan or guarantee to or from an assurance client or any of its directors or officers;
- c) undue dependence on total fees from an assurance client;
- d) concern about the possibility of losing the engagement;
- e) having a close business relationship with an assurance client;
- f) potential employment with an assurance client; and
- g) compensating an audit partner for selling non-assurance services to an assurance client.

2.20 A self-review threat occurs when any product or judgment of a previous assurance engagement or non-assurance engagement needs to be re-evaluated in reaching conclusions on the assurance engagement; or when a member or member of the assurance team was previously a director or officer of the assurance client or was an employee in a position to exert direct and significant influence over the subject matter of an assurance engagement.

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

- a) a member or member of the assurance team being, or having recently been, a director or officer of the assurance client;
- b) a member or member of the assurance team being, or having recently been, an employee of the assurance client that was in a position to exert direct and significant influence over the subject matter of the assurance engagement;
- c) performing services for an assurance client that directly affect the subject matter of the assurance engagement; and
- d) preparing original data for an assurance client that is used to generate financial statements or preparing other records that are the subject matter of the assurance engagement.

2.21 An advocacy threat occurs when a member, firm or member of the assurance team promotes or may be perceived to promote, an assurance client's position or opinion to the point that objectivity may, or may be perceived to be, compromised. This might be the case if a member, firm or member of the assurance team were to subordinate their judgment to that of the client.

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

- a) dealing in, or being a promoter of, shares or other securities of an assurance client; and
- b) acting as an advocate on behalf of an assurance client in litigation or in resolving disputes with third parties.

2.22 A familiarity threat occurs when, by virtue of a close relationship with an assurance client, its directors, officers or employees, a member, firm or member of the assurance team becomes too sympathetic to the client's interests.

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

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

2.23 An intimidation threat occurs when a member or member of the assurance team may be deterred from acting objectively and exercising professional scepticism by threats, actual or perceived, from the directors, officers or employees of an assurance client.

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

- a) threat of replacement due to a disagreement with the application of an accounting principle; and
- b) pressure to reduce inappropriately the extent of work performed in order to reduce fees.

### **Safeguards**

2.24 When threats that are more than clearly insignificant are identified, appropriate safeguards must be identified to eliminate the threats or reduce them to an acceptable level. The nature of the safeguards to be applied will vary depending upon the circumstances of a particular engagement. Consideration must always be given to what a reasonable and informed third party having knowledge of all of the relevant information, including safeguards, would reasonably conclude to be unacceptable. Such consideration will be affected by matters such as the significance of the threat, the nature of the assurance engagement, the intended users of the assurance report and the structure of the firm.

- 2.25 Safeguards fall into three broad categories:
- a) safeguards created by the profession, legislation or regulation;
  - b) safeguards within the assurance client; and
  - c) safeguards within the firm's own systems and procedures.
- 2.26 Safeguards created by the profession, legislation or regulation include the following:
- a) educational, training and experience requirements for both entry into the profession and the provision of public accounting services;
  - b) continuing professional development requirements;
  - c) professional standards and monitoring and disciplinary processes;
  - d) external practice reviews;
  - e) legislation governing the independence requirements of the firm, members and other professional colleagues; and
  - f) participation by members of the public in the governance of the profession.
- 2.27 Safeguards within the assurance client may include the following:
- a) the assurance client has competent employees to make managerial decisions;
  - b) policies and procedures that emphasize the assurance client's commitment to fair financial reporting;
  - c) internal procedures that ensure objective choices in commissioning non-assurance engagements; and
  - d) an audit committee that provides appropriate oversight and communications regarding a firm's service.
- 2.28 Safeguards within the firm's own systems and procedures may include firm-wide safeguards such as the following:
- a) firm leadership that stresses the importance of independence and the expectation that members and members of assurance teams will act in the public interest;
  - b) policies and procedures to implement and monitor quality control of assurance engagements;
  - c) documented independence policies regarding the identification of threats to independence, the evaluation of the significance of these threats and the identification and application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level;
  - d) internal policies and procedures to monitor compliance with firm policies and procedures as they relate to independence;
  - e) policies and procedures that will enable the identification of interests or relationships between the member, firm or members of the assurance team and assurance clients;

- f) policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single assurance client;
  - g) using different partners and staff with separate reporting lines for the provision of non-assurance services to an assurance client;
  - h) policies and procedures to prohibit staff who are not members of the assurance team from influencing the outcome of the assurance engagement;
  - i) timely communication of a member's or firm's policies and procedures, and any changes thereto, to all staff, including appropriate training and education;
  - j) designating a member of senior management to be responsible for overseeing the adequate functioning of the safeguarding system;
  - k) means of advising employees of those assurance clients and related entities from which they must be independent;
  - l) a disciplinary mechanism within the firm to promote compliance with policies and procedures; and
  - m) policies and procedures to empower staff to communicate to senior levels within the firm any issues of independence and objectivity that concern them; this includes informing staff of the procedures open to them.
- 2.29 Safeguards within the firm's own systems and procedures may include engagement specific safeguards such as the following:
- a) involving an additional professional colleague to review the work done or otherwise advise as necessary; this could include someone from outside the firm or network firm or someone from within the firm or network firm who was not otherwise associated with the assurance team;
  - b) consulting a third party, such as a committee of independent directors, a professional regulatory body, including a member advisor of an affiliate or another professional colleague;
  - c) rotating senior staff on the assurance team;
  - d) discussing independence issues with members of the audit committee or, in the absence of an audit committee, those charged with governance;
  - e) disclosing the nature of services provided and extent of fees charged to the audit committee, or in the absence of an audit committee, those charged with governance;
  - f) having policies and procedures to ensure members of the assurance team do not make, or assume responsibility for management decisions for the assurance client;
  - g) involving another firm to perform or re-perform part of the assurance engagement;
  - h) involving another firm to re-perform the non-assurance service to the extent necessary that will enable it to take responsibility for that service; and
  - i) removing a staff person from the assurance team, when that staff person's financial interests or relationships create a threat to independence.

- 2.30 Audit committees assume an important corporate governance role when they operate independently of client management and are able to assist the Board of Directors in satisfying them that a member or firm is independent in carrying out its audit role. There should be regular communications between the member or firm and the audit committee, or if there is no audit committee, those charged with governance, regarding relationships and other matters that might, in the member's or firm's opinion, reasonably be thought to bear on independence.
- 2.31 Requirements are set out for communication to those charged with governance in the CICA Handbook - Assurance. Members and firms are required to establish policies and procedures relating to regular independence communications with audit committees, or if there is no audit committee, those charged with governance. For audit engagements, the member or firm must communicate orally and in writing at least annually regarding all relationships and other matters between the member, firm or network firm and the audit client that, in the professional judgment of the member or staff person involved, may reasonably be thought to affect independence. Matters to be communicated will vary with the circumstances of the engagement; however, the communication should generally address the relevant independence matters set out in this Standard.
- 2.32 When the safeguards available, such as those described in the preceding paragraphs, are insufficient to eliminate the threats to independence or to reduce them to an acceptable level, or when a member or firm chooses not to eliminate the activities or interests creating the threat, the only course of action available will be the refusal to perform, or withdraw from, the assurance engagement.

#### ***Guidance for Sole Proprietors and Small Firms***

- 2.33 Small firms and sole proprietors have clients that are mainly owner-managed or small-sized enterprises. Many of the safeguards normally available within the firm or the assurance client would not be available.
- 2.34 Often these practitioners are relied upon by owner-managed and small-sized enterprise clients to provide them with a broad range of accounting and business services. In these circumstances independence will not be impaired provided safeguards are applied as required to eliminate or reduce any threat to an acceptable level and the services provided are not specifically prohibited by this Standard. For example, an appropriate safeguard might include explaining to the client the intention behind providing certain services and then obtaining the client's approval for the end result.
- 2.35 Small and medium-sized enterprise clients will often enjoy a long-standing personal relationship with a sole proprietor or small firm. In that situation independence will not be impaired provided safeguards are applied to reduce any familiarity threat that may result from that relationship to an acceptable level. In most circumstances the mandatory external practice review and, where appropriate, consultation with a third party such as a member advisor of an Affiliate or a professional colleague from outside the firm will reduce any potential threats to independence to an acceptable level.
- 2.36 Practitioners will find additional guidance throughout Section 4 — Application of the Framework in Specific Situations. In addition to the safeguards identified in paragraphs 2.24 to 2.32, paragraphs 4.51, 4.68 and 4.79 discuss issues and provide safeguards in circumstances that are common to small firms or sole proprietors. There is also a Guidance Bulletin on Independence for Sole Proprietors and Small Firms that is accessible through the Public Practice Manual CD.

### 3. ENGAGEMENT PERIOD

- 3.1 The member, members of the assurance team and firm must be independent of the assurance client during the period of the assurance engagement. The engagement period starts when the assurance team begins to perform assurance services and ends when the assurance report is issued, except when the assurance engagement is of a recurring nature. If the assurance engagement is expected to recur, the period of the assurance engagement ends with the notification by either party that the professional relationship has terminated or upon the issuance of the final assurance report, whichever is later. In the case of an audit engagement for a reporting issuer the engagement period ends when the audit client, member or the firm notifies the relevant Securities Commission that the audit client is no longer an audit client of the member or the firm.
- 3.2 In the case of an audit or review engagement, the period of the assurance engagement includes the period covered by the financial statements reported on by the member or the firm. When an entity becomes an audit or review client during or after the period covered by the financial statements that the member or firm will report on, the member or firm must consider whether any threats to independence may be created by:
- a) financial or business relationships with the client during or after the period covered by the financial statements, but prior to the acceptance of the engagement; or
  - b) previous services provided to the client.

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

- 3.3 If non-assurance services were provided to an audit or review client during or after the period covered by the financial statements but before the commencement of professional services in connection with the audit or review, and those services would be prohibited during the period of the audit or review engagement, consideration must be given to the threats to independence, if any, arising from those services. If the threat is other than clearly insignificant, safeguards must be considered and applied as necessary to reduce this threat to an acceptable level. Such safeguards might include:
- a) discussing independence issues related to the provision of the non-assurance services with the audit committee or, in the absence of an audit committee, those charged with governance;
  - b) obtaining the audit or review client's acknowledgement of responsibility for the results of the non-assurance services;
  - c) precluding staff who provided the non-assurance services from participating in the audit engagement; and
  - d) engaging another firm to review the results of the non-assurance services or having another firm re-perform the non-assurance services to the extent necessary to enable it to take responsibility for those services.

**Reporting Issuers**

- 3.4 Non-assurance services provided to an audit client that is not a reporting issuer will not impair the member, firm or network firm's independence when the client becomes a reporting issuer provided:
- a) the previous non-assurance services were permissible under this Standard for audit clients that were not reporting issuers;
  - b) the services will be terminated within a reasonable period of time of the client becoming a reporting issuer, if the services are not permissible under this Standard for reporting issuer audit clients; or
  - c) the member or the firm has implemented appropriate safeguards to eliminate, or reduce to an acceptable level, any threats to independence arising from the previous services.
- 3.5 For the purposes of complying with the specified prohibitions related to reporting issuers in this Standard, an entity becomes a reporting issuer by virtue of having market capitalization or total assets in excess of \$10,000,000. In the case of a period in which an entity makes a public offering, market capitalization is measured at the closing price on the day of the public offering and total assets refers to the total assets presented on the most recent financial statements, prepared in accordance with Canadian generally accepted accounting principles, that are included in the offering document.
- 3.6 When an entity becomes a reporting issuer by virtue of a public offering, the auditor of the entity is required, from that period forward until the entity ceases to be a reporting issuer, to comply with the specified prohibitions for reporting issuers in this Standard.

## 4. APPLICATION OF FRAMEWORK IN SPECIFIC SITUATIONS

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In accordance with <i>Code of Ethical Principles and Rules of Conduct</i> rule R202.1 (b), a member is required to comply with the specified prohibitions denoted in <i>italics</i> in this Standard.
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**Introduction**

- 4.1 The following examples describe the application of this Standard to specific circumstances, including the nature of the engagement and relationships that may create threats to independence. These examples describe the potential threats created and safeguards that may be applied by the member, firm, network firm and members of the assurance team to eliminate such threats or reduce them to an acceptable level in each circumstance.
- 4.2 The examples presented are not all-inclusive. In practice, the member, firm, network firm and members of the assurance team will be required to assess the implications of similar, but different, circumstances and relationships and to determine whether safeguards, including the safeguards in paragraphs 2.24 through 2.32, can be applied to satisfactorily address threats to independence. The introduction and framework sections of this Standard provide conceptual guidance to assist in this process.
- 4.3 The examples do not include assurance reports to a non-audit assurance client expressly restricted for use by identified users. As stated in paragraph 2.7, for such engagements, members of the assurance team and their immediate family and close relatives are required to be independent of the assurance client. Furthermore, the member and firm must not have a material financial interest, direct or indirect, in the assurance client.

**Financial Interest**

- 4.4 A financial interest in an assurance client may create a self-interest threat. In evaluating the significance of the threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, it is necessary to examine the nature of the financial interest. This includes an evaluation of the role of the individual holding the financial interest, the materiality of the financial interest and whether the financial interest is direct or indirect.
- 4.5 When evaluating whether the financial interest is direct or indirect, consideration must be given to the fact that financial interests range from those where the individual has no control over the financial interest held in an investment, for example, a mutual fund, unit trust, or similar intermediary vehicle, to those where the individual has control, including as a trustee, over the financial interest or is able to influence investment decisions of the entity in which the particular financial interest exists.
- 4.6 In evaluating the significance of any threat to independence, it is important to consider the degree of control or influence that can be exercised over the intermediary, the financial interest held and the investment strategy. When control exists, the financial interest is considered a direct interest. Conversely, when the holder of the financial interest has no ability to exercise such control, the financial interest is to be considered indirect.

*Provisions Applicable to all Assurance Clients*

- 4.7 *In the case of assurance clients, if a member, firm, staff or member of the assurance team or their immediate family member has a direct financial interest, or a material indirect financial interest, in the assurance client, the self-interest threat created would be so significant the only safeguards available to eliminate the threat or reduce it to an acceptable level would be to:*
- a) *dispose of the direct financial interest prior to the member or staff becoming a member of the assurance team;*

- b) *dispose of the indirect financial interest in total or a sufficient amount so that the remaining interest is clearly insignificant prior to the member or staff becoming a member of the assurance team; or*
  - c) *remove the member of the assurance team from the assurance engagement.*
- 4.8 If a member or member of the assurance team or their immediate family member receives, during the course of an assurance engagement, by way of, for example, an inheritance, gift or, as a result of a merger, a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat would be created. One of the safeguards set out in paragraph 4.7 must be applied at the earliest practical date.
- 4.9 During the period prior to disposal of the financial interest or removal of the member or staff from the assurance team, consideration must be given to whether additional safeguards are necessary to reduce the threat to an acceptable level. Such safeguards might include:
- a) discussing the matter with the audit committee or, in the absence of an audit committee, those charged with governance; and
  - b) involving another professional colleague who is not, and who has not been, involved in the assurance engagement to review the work done by the member of the assurance team with the close family relationship, or otherwise advise as necessary.
- 4.10 When a member of the assurance team knows that a close relative has a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat may be created and must be evaluated. In evaluating the significance of any threat, consideration must be given to the nature of the relationship between the member of the assurance team and the close relative as well as the materiality of the financial interest. Once the significance of this threat has been evaluated, safeguards must be considered and applied as necessary. Such safeguards might include:
- a) having the close relative dispose of all or a sufficient portion of their financial interest at the earliest practical date;
  - b) discussing the matter with the audit committee or, in the absence of an audit committee, those charged with governance;
  - c) involving an additional professional colleague who did not take part in the assurance engagement to review the work done or otherwise advise as necessary; and
  - d) removing that member of the assurance team from the assurance engagement.
- 4.11 *When a member, firm, staff or member of the assurance team or their immediate family member holds a direct financial interest or a material indirect financial interest in the assurance client as a trustee, the self-interest threat created would be so significant the only safeguards available to eliminate the threat or reduce it to an acceptable level would be to:*
- a) *dispose of the direct financial interest prior to the member or staff becoming a member of the assurance team;*
  - b) *dispose of the indirect financial interest in total or a sufficient amount so that the remaining interest is clearly insignificant, prior to the member or staff becoming a member of the assurance team; or*

- c) *remove the member of the assurance team from the assurance engagement.*
- 4.12 Consideration must be given to whether a self-interest threat may be created by the financial interests of individuals outside of the assurance team and their immediate family and close relatives. Such individuals would include:
- a) partners who are not members of the assurance team and their immediate family members;
  - b) partners and managerial staff who provide a non-assurance service to the assurance client;
  - c) a spouse or a dependant of an immediate family member or close relative of a member of the assurance team who has a close personal relationship with a member of the assurance team; and
  - d) an individual for whom a member of the assurance team holds power of attorney.
- 4.13 Whether the financial interests held by such individuals might create a self-interest threat will depend upon factors such as:
- a) the firm's organizational, operating and reporting structure;
  - b) the nature of the relationship between the individual and member of the assurance team; and
  - c) in the case of a power of attorney, the degree of decision-making power granted by that power of attorney.
- 4.14 The significance of the threat must be evaluated and, if this threat is other than clearly insignificant, safeguards must be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:
- a) policies to restrict staff from holding such interests;
  - b) discussing the matter with the audit committee or, in the absence of an audit committee, those charged with governance; and
  - c) involving an additional professional colleague who did not take part in the assurance engagement to review the work done or otherwise advise as necessary.
- 4.15 An inadvertent violation of this Standard as it relates to a financial interest in an assurance client would not impair the independence of the member, firm or member of the assurance team when:
- a) the member, firm or network firm has established policies and procedures in place that require all staff of the firm or network firm to report promptly to the member or firm any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;
  - b) the member, firm or network firm promptly notifies the staff that the financial interest must be disposed of; and
  - c) this disposal occurs at the earliest practical date after identification of the issue of the financial interest or the person is removed from the assurance team.

- 4.16 When an inadvertent violation of this Standard relating to a financial interest in an assurance client has occurred, the member or firm must consider whether any safeguards should be applied. Such safeguards might include:
- a) involving an additional professional colleague who did not take part in the assurance engagement to review the work done by the member of the assurance team; and
  - b) excluding the particular person from any substantive decision-making concerning the assurance engagement.

*Provisions Applicable to Audit or Review Clients*

- 4.17 *If a member, firm, staff, network firm or member of the assurance team or their immediate family member has a direct financial interest in an audit or review client of the firm, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the member, firm or network firm or staff of the member, firm or network firm to perform the engagement.*
- 4.18 *If a member, firm, staff, network firm or member of the assurance team or their immediate family member has a material indirect financial interest in an audit or review client of the firm, a self-interest threat created would be so significant the only actions appropriate to permit the member, firm or network firm to perform this engagement would be to dispose of the indirect interest in total or to dispose of a sufficient amount of it such that the remaining interest is clearly insignificant.*
- 4.19 *If a member, firm, staff, network firm or member of the assurance team or their immediate family member has a direct or a material indirect financial interest in an entity that has a controlling interest in an audit or review client, the self-interest threat created would be so significant no safeguard could reduce this self-interest threat to an acceptable level. The only actions appropriate to permit the member, firm or network firm to perform this engagement would be for the member, firm, or network firm or staff of the member, firm or network firm to either dispose of the financial interest in total or, in the case of an indirect financial interest, to dispose of a sufficient amount of it such that the remaining interest is clearly insignificant.*
- 4.20 *If the pension or other retirement plan of a member, firm staff or network firm has a direct or material indirect financial interest in an audit or review client, the self-interest threat created would be so significant no safeguard could reduce this self-interest threat to an acceptable level. The only actions appropriate to permit the member, firm or network firm to perform this engagement would be for the member, firm, or network firm or staff of the member, firm or network firm to either dispose of the financial interest in total or, in the case of an indirect financial interest, to dispose of a sufficient amount of it such that the remaining interest is clearly insignificant.*
- 4.21 *If other partners, including partners who do not perform assurance engagements, or a member of such a partner's immediate family, in the office in which the lead engagement partner practices in connection with an audit or review engagement holds a direct financial interest or a material indirect financial interest in that audit or review client, the self-interest threat created would be so significant no safeguard could reduce that threat to an acceptable level. Accordingly, such partners or members of their immediate family shall not hold any such financial interests in that audit or review client.*

4.22 *If other partners and managerial staff who provide non-assurance services to an audit or review client, except those whose involvement is clearly insignificant, or a member of their immediate family, holds a direct financial interest or a material indirect financial interest in the audit or review client, the self-interest threat created would be so significant that no safeguard could reduce this threat to an acceptable level. Accordingly, such staff or members of their immediate family shall not hold any such financial interests in that audit or review client.*

4.23 A financial interest in an audit or review client that is held by an immediate family member of:

- a) a partner located in the office in which the lead engagement partner practices in connection with the audit or review; or
- b) a partner or managerial staff person who provides non-assurance services to the audit or review client;

is not considered to create an unacceptable threat if received as a result of the immediate family member's employment rights, including pension rights or shares option, and where necessary, appropriate safeguards are applied to reduce any threat to independence to an acceptable level.

4.24 *A self-interest threat may be created if the member, firm, staff, network firm or member of the assurance team has a financial interest in an entity and an audit or review client, or a director, officer or controlling owner thereof, also has a financial interest in that entity. Independence with respect to the audit or review client is not compromised if the respective financial interests of the member, firm, network firm or member of the assurance team, and the audit or review client, or director, officer or controlling owner thereof, are both immaterial and the audit or review client cannot exercise significant influence over the entity. However, if the financial interest is material, either to the member, firm, staff, network firm, member of the assurance team or the audit or review client, or the audit or review client can exercise significant influence over the entity, no safeguards are available to reduce this threat to an acceptable level. Therefore the member, firm or network firm or staff of the member, firm or network firm shall either dispose of the financial interest or decline the audit or review engagement. Any member of the assurance team with such a material interest shall either:*

- a) *dispose of the financial interest;*
- b) *dispose of a sufficient amount of the financial interest so that the remaining interest is no longer material; or*
- c) *withdraw from the audit or review .*

*Provisions Applicable to Non-audit or Non-Review Assurance Clients*

4.25 *If a member or firm has a direct financial interest in an assurance client that is not an audit or review client, the self-interest threat created would be so significant that no safeguard could reduce this threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the member or firm to perform this engagement.*

4.26 *If a member or firm has a material indirect financial interest in an assurance client that is not an audit or review client, a self-interest threat is also created. The only action appropriate to*

*permit the member or firm to perform this engagement would then be for the member or firm to either dispose of the indirect interest in total or to dispose of a sufficient amount of it such that the remaining interest is clearly insignificant.*

- 4.27 *If a member or firm has a material financial interest in an entity that has a controlling interest in an assurance client that is not an audit or review client, the self-interest threat created would be so significant that no safeguard could reduce this threat to an acceptable level. The only action appropriate to permit the member or firm to perform this engagement would be for the member or firm to either dispose of the financial interest in total or to dispose of a sufficient amount of it such that the remaining interest is clearly insignificant.*

### **Loans and Guarantees**

- 4.28 A loan from, or guarantee by, an assurance client that is a bank or a similar institution, to the member, firm or member of the assurance team, would not create a threat to independence provided the loan or guarantee is made under normal lending procedures, terms and requirements and the loan or guarantee is immaterial to the member, firm or member of the assurance team and the assurance client and the loan or guarantee is made under normal commercial terms and conditions and is in good standing.
- 4.29 A loan from, or guarantee by, an assurance client that is a bank or a similar institution, to a member of the assurance team's immediate family, would not create a threat to independence provided the loan or guarantee is made under normal lending procedures, terms and requirements. Examples of such loans or guarantees include home mortgages, bank overdrafts, car loans and credit card balances.
- 4.30 Deposits made by, or to brokerage accounts of, a firm or member of the assurance team with an assurance client that is a bank, broker or similar institution, would not create a threat to independence provided the deposit or account is held under normal commercial terms.
- 4.31 *If the member or firm makes a loan to an assurance client, an officer or director of the client or a shareholder of the client that owns more than 10% of the equity, the self-interest threat created would be so significant that no safeguard could reduce this threat to an acceptable level, unless that loan is to a bank or similar institution and is immaterial to the member, firm and the assurance client and is made under normal commercial terms and conditions. Consequently the only course of action is to decline to perform or withdraw from the assurance engagement. In the case of an audit or review client this provision shall apply to network firms.*
- 4.32 *If the member or firm guarantees a loan of the client, an officer or director of the client or shareholder of the client that owns more than 10% of the equity, the self-interest threat created would be so significant that no safeguard could reduce this threat to an acceptable level. Consequently the only course of action is to decline to perform or withdraw from the assurance engagement. In the case of an audit or review client this provision shall apply to network firms.*
- 4.33 *If the member or firm accepts a loan or guarantee from, or has borrowing guaranteed by, an assurance client, an officer or director of the client or a shareholder of the client that owns more than 10% of the equity, the self-interest threat created would be so significant that no safeguard could reduce this threat to an acceptable level, unless the loan or guarantee is from a bank or similar institution and is immaterial to the member, firm and the assurance client and the loan or guarantee is made under normal commercial terms and conditions and is in good standing. Consequently the only course of action is to decline to perform or*

*withdraw from the assurance engagement. In the case of an audit or review client this provision shall apply to network firms.*

- 4.34 *If a member of an assurance team makes a loan to an assurance client that is not a bank or similar financial institution or an officer or director of the client or a shareholder of the client that owns more than 10% of the equity, or guarantees such borrowings, the self-interest threat created would be so significant that no safeguard could reduce this threat to an acceptable level and the member of the assurance team shall not participate on the assurance team. If the loan is to a bank or similar institution the loan must be made under normal commercial terms and conditions and the loan must be in good standing.*
- 4.35 *If a member of an assurance team accepts a loan or guarantee from, or has borrowing guaranteed by, an assurance client that is not a bank or similar institution, an officer or director of the client or a shareholder of the client that owns more than 10% of the equity, the self-interest threat created would be so significant that no safeguard could reduce this threat to an acceptable level and the member of the assurance team shall not participate on the assurance team. If the loan is from a bank or similar institution the loan must be made under normal commercial terms and conditions and the loan must be in good standing.*

### ***Close Business Relationships***

- 4.36 A close business relationship between a member, firm or a member of the assurance team and the assurance client or its management, or between the member, firm, network firm and an audit or review client, will involve a commercial or common financial interest and may create self-interest and intimidation threats. The following are examples of such relationships:
- a) having a material financial interest in a joint venture with the assurance client or a controlling owner, director, officer or other individual who performs senior managerial functions for that client;
  - b) arrangements to combine one or more services or products of the firm with one or more services or products of the assurance client and to market the package with reference to both parties; and
  - c) distribution or marketing arrangements under which the firm acts as a distributor or marketer of the assurance client's products or services, or the assurance client acts as the distributor or marketer of the products or services of the firm.
- 4.37 *In the case of an audit or review client, unless the financial interest is immaterial and the relationship, as described in paragraph 4.36 is clearly insignificant to the member, firm, network firm and the audit or review client and its management, no safeguards could reduce the intimidation or self-interest threat to an acceptable level. Similarly, in the case of an assurance client that is not an audit or review client, unless the financial interest is immaterial and the relationship is clearly insignificant to the member or firm and the assurance client, no safeguards could reduce this threat to an acceptable level. Consequently, in both these circumstances the only possible courses of action would be to:*
- a) *terminate the business relationship;*
  - b) *reduce the magnitude of that relationship so that the financial interest is immaterial and the relationship is clearly insignificant; or*
  - c) *decline to perform the assurance engagement.*

- Unless any such financial interest is immaterial and the relationship is clearly insignificant to the member of the assurance team, the only appropriate safeguard would be to remove that staff person from the assurance team.*
- 4.38 In the case of an audit or review client, business relationships involving an interest held by the firm, network firm, a member of the assurance team or their immediate family in a closely held entity when the audit or review client or a director or an officer of the audit or review client or any group thereof, also has an interest in that entity, do not create threats to independence provided that:
- a) the relationship is clearly insignificant to the member, firm, network firm and the audit or review client;
  - b) the interest held is immaterial to the investor or group of investors; and
  - c) the interest does not give the investor or group of investors the ability to control the closely held entity.
- 4.39 The purchase of goods and services from an assurance client by the member or firm, or from an audit or review client by a network firm or a member of the assurance team would not generally create a threat to independence providing the transaction is conducted in the normal course of business and at an arm's-length basis. However, such transactions may be of a nature or magnitude so as to create a self-interest threat. If the threat created is other than clearly insignificant, safeguards must be considered and applied as necessary to reduce this threat to an acceptable level. Such safeguards might include:
- a) eliminating or reducing the magnitude of the transaction;
  - b) removing the staff person from the assurance team; and
  - c) discussing the issue with the audit committee or, in the absence of an audit committee, those charged with governance.

#### ***Family and Personal Relationships***

- 4.40 Family and personal relationships between a member of the assurance team and a director, officer or certain employees of the client, depending on their role, may create self-interest, familiarity or intimidation threats. It is impractical to attempt to describe in detail the significance of the threats such relationships may create. The significance will depend upon a number of factors, including the staff person's responsibilities on the assurance engagement, the closeness of that relationship and the role of the family member or other individual within the assurance client. Consequently, there is a wide spectrum of circumstances that will need to be evaluated before the application of safeguards.
- 4.41 *When an immediate family member of a member of the assurance team is a director, officer or employee of the assurance client and is in a position to exert direct and significant influence over the subject matter of the assurance engagement, or was in such a position during any period covered by the engagement, any threats to independence can only be reduced to an acceptable level by removing that staff person from the assurance team. The closeness of the relationship would be such that no other safeguard could reduce that threat to independence to an acceptable level. If the application of this safeguard is not used, the only course of action is to withdraw from the assurance engagement. In the case of an audit of a reporting issuer this prohibition extends to close family.*

- 4.42 For example, in the case of an audit of financial statements, if the spouse of a member of the assurance team is an employee of the client and is in a position to exert direct and significant influence on the preparation of the audit client's accounting records or financial statements, the threat to independence could only be reduced to an acceptable level by removing that staff person from the assurance team.
- 4.43 In the case of engagements other than an audit of a reporting issuer, when a close relative of a member of the assurance team is a director, an officer or an employee of the assurance client and is in a position to exert direct and significant influence over the subject matter of the assurance engagement, or was in such a position during any period covered by the engagement, threats to independence may be created. The significance of these threats will depend on factors such as:
- a) the position the close relative holds with the client; and
  - b) the role of the member of the assurance team.
- 4.44 The significance of any threat identified in the preceding paragraph must be evaluated and, if the threat is other than clearly insignificant, safeguards must be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:
- a) removing the person from the assurance team;
  - b) where possible, structuring the responsibilities of the assurance team so that the person does not deal with matters within the responsibility of the close relative; and
  - c) establishing policies and procedures that empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.
- 4.45 Self-interest, familiarity or intimidation threats may also be created when a person who is other than an immediate family member or a close relative of a member of the assurance team has a close relationship with the member of the assurance team and is a director, officer or employee of the assurance client that is in a position to exert direct and significant influence over the subject matter of the assurance engagement. Therefore, members of the assurance team are responsible for identifying such persons and for consulting the firm's policies and procedures. An evaluation of the significance of any threat created and the safeguards appropriate to eliminate this threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship and the role of the person within that assurance client.
- 4.46 Consideration should be given to whether self-interest, familiarity or intimidation threats might be created by a personal or family relationship between a staff person of the firm, who is not a member of the assurance team, and a director, officer or employee of the assurance client that is in a position to exert direct and significant influence over the subject matter of the assurance engagement. Staff of the firm are therefore responsible for identifying any such relationships and for consulting the firm's policies and procedures. Any evaluation of the significance of a threat that has been created and the safeguards appropriate to eliminate that threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship, the interaction of the firm or staff person with the team, their position held within the firm, and the role of that staff person within the assurance client.

- 4.47 An inadvertent violation of the prohibitions as they relate to family and personal relationships would not impair the independence of a member, firm or member of the assurance team when:
- a) the member or firm has established policies and procedures that require all staff report promptly to the member or firm any breaches resulting from changes in the employment status of their immediate family members or close relatives or other personal relationships that create threats to independence;
  - b) the member or firm promptly removes that staff person from the assurance engagement; and
  - c) additional care is given to reviewing the work of that staff person.
- 4.48 When an inadvertent violation of the prohibitions as they relate to family and personal relationships has occurred, the member or firm must consider whether any safeguards should be applied. Such safeguards might include:
- a) involving an additional professional colleague who did not take part in the assurance engagement to review the work done by the member of the assurance team; and
  - b) excluding the staff person from any substantive decision-making concerning the assurance engagement.

### ***Employment***

- 4.49 A member, firm or member of the assurance team's independence may be threatened if a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement has been a member of the assurance team or partner of the firm. Such circumstances may create self-interest, familiarity and intimidation threats, particularly when significant connections remain between the individual and the former firm. Similarly, a member of the assurance team's independence may be threatened when they participate in the assurance engagement knowing, or having reason to believe, that they may join the assurance client at some time in the future.
- 4.50 If a member of the assurance team, partner or former partner of the firm has joined the assurance client, the significance of the self-interest, familiarity or intimidation threat created will depend upon the following factors:
- a) the position the individual has taken at the assurance client, including whether that position involves direct or significant influence over the subject matter;
  - b) the amount of any involvement that individual will have with the assurance team;
  - c) the length of time that has passed since the individual was a member of the assurance team or firm; and
  - d) the former position of the individual within the assurance team or firm.
- 4.51 The significance of a threat must be evaluated and, if that threat is other than clearly insignificant, safeguards must be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:
- a) considering the appropriateness or necessity of modifying the assurance plan for the assurance engagement;

- b) assigning an assurance team to the subsequent assurance engagement that has commensurate experience with the client as the individual who has joined the assurance client;
  - c) involving an additional professional colleague who was not a member of the assurance team to review the work done or otherwise advise as necessary; and
  - d) perform a quality control review of the assurance engagement.
- 4.52 In all cases, all of the following safeguards are necessary to reduce any threat to an acceptable level:
- a) the individual concerned is not entitled to any benefits or payments from the member or firm unless these are made in accordance with fixed, pre-determined arrangements. Furthermore, any amount owed to that individual must not be of such significance to threaten the member or firm's independence; and
  - b) the individual does not continue to participate or appear to participate in the member or firm's business or professional activities.
- 4.53 A self-interest threat is created when a member of the assurance team participates in the assurance engagement while knowing, or having reason to believe, that they may join the assurance client at some time in the future. This threat can be reduced to an acceptable level by application of the following safeguards:
- a) policies and procedures that require a member of the assurance team to notify the member or firm when entering serious employment negotiations with the assurance client; and
  - b) removal of the member of the assurance team from the assurance engagement at that time.

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

- 4.54 *In the case of an audit engagement of a reporting issuer, if a member or staff person who has participated in an audit capacity in an audit of the financial statements of the entity performed by the member or firm has accepted employment in a financial oversight role with respect to the entity, the threat to independence would be so significant that no safeguard could reduce this self-interest threat to an acceptable level. Accordingly, a member or firm shall not perform an audit engagement for this entity. This restriction applies until a period of one year has elapsed from the date the financial statements were filed with the relevant securities regulator or stock exchange.*

### **Recent Service**

- 4.55 To have a former officer, director or employee of the assurance client serve as a member of the assurance team may create self-interest, self-review and familiarity threats. This would be particularly true when a member of the assurance team has to report on, for example, subject matter they had prepared or on elements of the financial statements they had valued while with the assurance client.
- 4.56 *If, during the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement,*

*the self-interest, self-review and familiarity threat created would be so significant no safeguard could reduce this threat to an acceptable level. Consequently, such staff shall not be assigned to the assurance team.*

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

The significance of the threat must be evaluated and, if that threat is other than clearly insignificant, safeguards must be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include involving an additional professional colleague to review the work done by the staff person as part of the assurance team or otherwise advise as necessary, or discussing the issue with audit committee or, in the absence of an audit committee, those charged with governance.

#### ***Serving as an Officer or Director on the Board***

- 4.58 *If a member or staff of the firm serves as an officer or as a director on the board of an assurance client, the self-review and self-interest threats created would be so significant that no safeguard could reduce those threats to an acceptable level. In the case of an audit or review engagement, if a member or staff of a network firm were to serve as an officer or as a director on the board, the threat created would be so significant that no safeguard could reduce these threats to an acceptable level. Consequently, the only course of action is to decline to perform or withdraw from the assurance engagement. In the case of a reporting issuer audit client, the requirement extends to a related entity.*

#### ***Long Association of Senior Staff***

##### *Provisions Applicable to all Assurance Clients*

- 4.59 Using the same senior staff on an assurance engagement over an extended period of time may create a familiarity threat. The significance of the threat will depend upon factors such as:
- a) the length of time the individual has been a member of the assurance team;
  - b) the role of the individual on the assurance team;
  - c) the structure of the firm; and
  - d) the nature of the assurance engagement.
- 4.60 The significance of the threat must be evaluated and, if the threat is other than clearly insignificant, safeguards must be considered and applied to reduce this threat to an acceptable level. Such safeguards might include:

- a) rotating senior staff off the assurance team;
- b) involving a professional colleague who was not a member of the assurance team to review the work done by the senior staff or otherwise advise as necessary; or
- c) independent internal quality reviews.

*Provisions Applicable to Audit Clients that are Reporting Issuers*

4.61 *Using the same lead engagement partner or an engagement quality control reviewer on an audit engagement over a prolonged period may create a familiarity threat. This threat is particularly relevant in the context of the audit of reporting issuers and safeguards must be applied in such situations to reduce the threat to an acceptable level. The following shall apply for the audit of reporting issuers:*

- a) *the lead engagement partner and the engagement quality control reviewer shall be rotated after a period of no more than five years; and*
- b) *a member who is other than a lead engagement partner referred to in 4.61(a) who, during the engagement period, provides more than ten hours of assurance services or who is a subsidiary engagement partner shall be rotated off after a period of no more than seven years; and*
- c) *persons rotating off the audit of a reporting issuer pursuant to 4.61 (a) shall not participate in the assurance engagement as an engagement partner or engagement quality control reviewer until a further five years has elapsed. In the case of 4.61 (b) the member shall not participate in the assurance engagement as an engagement partner until a period of two years has elapsed. In the case of an audit engagement that is a mutual fund, the engagement partner shall not thereafter perform the role of engagement partner of the reporting issuer or another mutual fund that is in the same mutual fund complex as the reporting issuer until a further two-year-period has elapsed; and*
- d) *in the case of an audit engagement of a reporting issuer that is a mutual fund, the engagement partner and the engagement quality control reviewer shall not thereafter resume or assume either such role with the reporting issuer or another mutual fund that is in the same mutual fund complex as the reporting issuer until a further five-year-period has elapsed.*

***Provision of Professional Services to a Reporting Issuer Audit Client***

4.62 *In the case of an audit client that is a reporting issuer, or a related entity, approval must be obtained from the client's audit committee or, in the absence of an audit committee, those charged with governance before a member or firm provides a professional service.*

***Provision of Non-assurance Services***

4.63 Members and firms have traditionally provided to their assurance clients a range of non-assurance services that are consistent with their skills and expertise. Assurance clients value the benefits that derive from having these members and firms who have a good understanding of the business bring their knowledge and skill to bear in other areas. Furthermore, the provision of such non-assurance services will often result in the assurance team obtaining information regarding the assurance client's business and operations that is helpful in relation to the assurance engagement. The greater the knowledge of the assurance client's business,

the better the assurance team will understand the assurance client's procedures and controls, and the business and financial risks that it faces.

The provision of non-assurance services may, however, create threats to the independence of the member, firm, staff of the member, network firm or member of the assurance team, particularly with respect to perceived threats to independence. Consequently, it is necessary to evaluate the significance of any threat created by the provision of such services. In some cases it may be possible to eliminate or reduce the threat created by application of safeguards. In other cases no safeguards are available to reduce the threat to an acceptable level.

4.64 *In the case of an assurance engagement, if the member or firm performed the following activities during an engagement period it would create self-interest or self-review threats so significant that only avoidance of the activity or declining the assurance engagement would reduce these threats to an acceptable level:*

- a) *authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of the assurance client or having the authority to do so;*
- b) *determining which recommendation of the member or firm will be implemented; and*
- c) *reporting, in a management role, to those charged with governance of the client.*

4.65 *In the case of an audit engagement of a reporting issuer, if the member, firm or network firm makes a management decision or performs a management function including those listed in the preceding paragraph during either the period covered by the financial statements that are subject to audit or the engagement period, for the entity or a related entity, the threat to independence would be so significant that no safeguard could reduce the threat to an acceptable level. Accordingly, a member, firm or network firm or staff of the member, firm or network firm shall not perform such an audit engagement.*

4.66 When non-assurance services are provided to an assurance client, threats to independence that are difficult to detect might arise, most frequently when provided to review or audit client and particularly when the non-assurance services involve other than the preparation of quantifiable financial information. Such services could, for example, involve matters such as information technology systems, valuation or insolvency advice or management consulting. When the non-assurance service provided is not related to the subject matter of the assurance engagement, threats to independence will generally be considered to be insignificant.

In all cases, however, consideration must be given to the significance of the member's, the firm's or network firm's involvement with the subject matter of the assurance engagement, particularly with respect to the creation of any potential self-review threats to independence. If such threats are created, consideration must be given to whether they can be eliminated or reduced to an acceptable level by safeguards. If such threats cannot be eliminated or reduced, then the assurance engagement must be declined.

4.67 The following activities also create self-review or self-interest threats:

- a) having custody of an assurance client's assets;
- b) supervising assurance client employees in the performance of their normal recurring activities; and
- c) preparing source documents or originating data, in electronic or another form, evidencing the occurrence of a transaction, for example, purchase orders, payroll time records and customer orders.

- 4.68 The significance of any threat created must be evaluated and, if the threat is other than clearly insignificant, safeguards must be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:
- a) making arrangements so that staff providing such services do not participate in the assurance engagement; and
  - b) involving an additional professional colleague to advise on the potential impact of these activities on the independence of the member, firm and the assurance team.
- 4.69 New developments in business, the evolution of financial markets, rapid changes in information technology and the consequences for management and control make it impossible to draw up an all-inclusive list of all situations when providing non-assurance services to an assurance client might create threats to independence and of the different safeguards that might eliminate these threats or reduce them to an acceptable level. In general, a member or firm may provide services beyond the assurance engagement provided any threats to independence have been reduced to an acceptable level.
- 4.70 The following safeguards may be particularly relevant in reducing threats created by the provision of non-assurance services to assurance clients to an acceptable level:
- a) policies and procedures to prohibit staff from making management decisions for the assurance client or assuming responsibility for such decisions;
  - b) discussing independence issues related to the provision of non-assurance services with the audit committee or, in the absence of an audit committee, those charged with governance;
  - c) policies within the assurance client regarding the oversight responsibility for provision of non-assurance services by the member or firm;
  - d) involving an additional professional colleague to advise on the potential impact of the non-assurance engagement on the independence of the member of the assurance team and the member or firm;
  - e) involving an additional professional colleague outside of the firm, to provide assurance on a discrete aspect of the assurance engagement;
  - f) obtaining the assurance client's acknowledgement of responsibility for the results of the work performed by the member or firm;
  - g) disclosing the nature and extent of fees charged to the audit committee or, in the absence of an audit committee, those charged with governance; and
  - h) making arrangements so that a staff person providing non-assurance services does not participate in the assurance engagement.
- 4.71 Before the member or firm accepts an engagement to provide a non-assurance service to an assurance client, consideration must be given to whether the provision of such a service would create a threat to independence. In situations when a threat created is other than clearly insignificant, the non-assurance engagement must be declined unless appropriate safeguards can be applied to eliminate the threat or reduce it to an acceptable level.
- 4.72 The provision of certain non-assurance services to audit or review clients may create threats to independence so significant that no safeguard could eliminate the threats or reduce them to

an acceptable level. However, the provision of such services to a related entity, division or discrete financial statement item of such clients may be permissible when any threats to the member's or firm's independence have been reduced to an acceptable level by arrangements for that related entity, division or discrete financial statement item to be audited by another firm or when another firm re-performs the non-assurance service to the extent necessary to enable it to take responsibility for that service.

### **Preparing Accounting Records and Financial Statements**

- 4.73 The examples in paragraphs 4.74 through 4.77 indicate that self-review threats may be created if the member or firm is involved in the preparation of accounting records or financial statements and those financial statements are subsequently the subject matter of an audit or review engagement of the member or firm. This notion may be equally applicable in situations when the subject matter of the assurance engagement does not involve financial statements. For example, a self-review threat would be created if the member or firm developed and prepared prospective financial information and subsequently provided assurance on this information. Consequently, the member or firm must evaluate the significance of any self-review threat created by the provision of such services. If the self-review threat is other than clearly insignificant, safeguards must be considered and applied as necessary to reduce the threat to an acceptable level.
- 4.74 Assisting an audit or review client in matters such as preparing accounting records or financial statements may create a self-review threat when the member or firm subsequently performs the audit or review engagement on the client's financial statements.
- 4.75 *It is the responsibility of client management to ensure that accounting records are kept and financial statements are prepared, although they may request the member or firm performing the assurance engagement to provide assistance. If, during an audit or review engagement, a member or staff from the firm or network firm, providing such assistance makes management decisions, the self-review threat created could not be reduced to an acceptable level by any safeguards. Consequently, a member or staff of the firm or network firm must not make such decisions. If such decisions are made, the only course of action would be to withdraw from the engagement.*
- 4.76 Examples of prohibitions in the preceding paragraph include the following:
- a) determining or changing journal entries or the classification for accounts or transactions or other accounting records without obtaining the approval of the audit or review client;
  - b) authorizing or approving transactions; and
  - c) preparing source documents or originating data, including decisions on valuation assumptions or making changes to such documents or data.
- 4.77 The audit and review process involves extensive dialogue between the member or firm and management of the client. During this process, management requests and receives significant input regarding such matters as accounting principles and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. Technical assistance of this nature and advice on accounting principles for clients are an appropriate means to promote the fair presentation of the financial statements. The provision of such advice does not generally threaten the member's or firm's independence. Similarly, the audit or review process may involve assisting a client in resolving account reconciliation problems, analyzing and accumulating information for regulatory reporting, assisting in the preparation of consolidated financial statements, drafting

disclosure items and proposing adjusting journal entries. These services are considered to be a normal part of the audit and review process and do not, under normal circumstances, threaten independence.

- 4.78 The member, firm or network firm may provide an audit or review client that is not a reporting issuer with accounting and bookkeeping services, including payroll services, of a routine or mechanical nature, provided any self-review threat created is reduced to an acceptable level. Examples of such services include:
- a) recording transactions for which the audit or review client has determined or approved the appropriate account classification;
  - b) posting coded transactions to the audit or review client's general ledger;
  - c) preparing financial statements based on information in the trial balance; and
  - d) posting audit client approved entries to the trial balance.
- 4.79 The significance of any threat created must be evaluated and, if the threat is other than clearly insignificant and the client is not a reporting issuer, safeguards must be considered and applied as necessary to reduce this threat to an acceptable level. Safeguards might include:
- a) making arrangements so such services are not performed by a member of the assurance team;
  - b) implementing policies and procedures to prohibit a member of the assurance team providing such services from making any managerial decisions on behalf of the audit or review client;
  - c) requiring the source data for the accounting entries to be originated by the audit or review client;
  - d) requiring the underlying assumptions to be originated and approved by the audit or review client; and
  - e) obtaining audit or review client approval for any proposed journal entries or other changes affecting the financial statements.

*Provisions Applicable to a Reporting Issuer Audit Client*

- 4.80 *For an audit client that is a reporting issuer, the provision of accounting and bookkeeping services, including payroll services and the preparation of financial statements or financial information which forms the basis of the financial statements on which the audit report is provided will impair the independence of the member, firm or network firm or give the appearance of impairing independence. Accordingly, no safeguard could reduce the threat created to an acceptable level. Therefore, a member, firm or network firm or staff of the member, firm or network firm shall not provide such services to audit clients that are reporting issuers.*

**Provision of Valuation Services**

- 4.81 A valuation comprises the making of assumptions with regard to future developments and the application of certain methodologies and techniques, and the combination of both in order to compute a certain value or range of values, for an asset, a liability or for a business as a whole.

- 4.82 A self-review threat may be created when a member, firm or network firm performs a valuation for an audit client that is to be incorporated into the client's financial statements.
- 4.83 *If the valuation service provided to an audit or review client involves the valuation of matters material to the financial statements and the valuation involves a significant degree of subjectivity, the self-review threat created could not be reduced to an acceptable level by the application of any safeguard. Accordingly, such valuation services shall not be provided or, alternatively, the only course of action would be to withdraw from the engagement.*
- 4.84 *A member, firm or network firm shall not perform an audit engagement of a reporting issuer if, during either the period covered by the financial statements that are subject to audit, or the engagement period, the member, firm, network firm or a staff of the firm or network firm provides a valuation service to the client or a related entity. This restriction applies unless it is reasonable to conclude the results of that service will not be subject to audit procedures during the financial statement audit. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the valuation service will be subject to audit procedures.*

*Provisions Applicable to All Assurance Clients*

- 4.85 Performing valuation services that are not material to the financial statements, either separately or in the aggregate, or that do not involve a significant degree of subjectivity, may create a self-review threat that could be reduced to an acceptable level by the application of safeguards. Such safeguards might include:
- a) involving an additional professional colleague who was not a member of the assurance team to review the work done or otherwise advise as necessary;
  - b) confirming with the audit client their understanding of the underlying assumptions of the valuation and the methodology to be used and obtaining approval for their use;
  - c) obtaining the audit client's acknowledgement of responsibility for the results of the work performed by the member or firm; and
  - d) making arrangements so that the staff person providing such services does not participate in the audit engagement.
- 4.86 In determining whether safeguards, such as those listed in the preceding paragraph, would be effective, consideration must be given to the following matters:
- a) the extent of the audit client's knowledge, experience and ability to evaluate the issues concerned, and the extent of their involvement in determining and approving significant matters of judgment;
  - b) the degree to which established methodologies and professional guidelines are applied when performing a particular valuation service;
  - c) the degree of subjectivity inherent in the item concerned for valuations involving standard or established methodologies;
  - d) the reliability and extent of the underlying data;
  - e) the degree of dependence on future events of a nature which could create significant volatility inherent in the amounts involved; and

- f) the extent and clarity of the disclosures in the financial statements.
- 4.87 When a member, firm or network firm performs a valuation service for an audit client for the purposes of making a filing or return to a tax authority, computing an amount of tax due by the assurance client, or for the purpose of tax planning, this would not create a significant threat to independence because such valuations are generally subject to external review by, for example, a tax authority.
- 4.88 When the member, firm or network firm performs a valuation that forms part of the subject matter of an assurance engagement that is not an audit engagement, the member, firm or network firm, or staff of the member, firm or network firm must consider any self-review threats. If the threat is other than clearly insignificant, safeguards must be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

#### **Provision of Actuarial Services**

- 4.89 The member, firm or a network firm may be asked to provide actuarial services to an audit client. Such assignments are generally not seen to create threats to independence except in the circumstances set out in paragraph 4.93.
- 4.90 *A member, firm or network firm shall not perform an audit engagement of a reporting issuer if, during either the period covered by the financial statements subject to audit or the engagement period, the member, firm, network firm or staff of the member, firm or network firm provides an actuarial service to the client or a related entity unless it is reasonable to conclude the results of that service will not be subject to audit procedures during the financial statement audit. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the actuarial service will be subject to audit procedures.*

#### **Provision of Taxation Services**

- 4.91 The member or firm may be asked to provide taxation services to an assurance client. Taxation services comprise a broad range of services, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes. Such assignments are generally not seen to create threats to independence.

#### **Provision of Internal Audit Services**

- 4.92 A self-review threat may be created when a member, firm or network firm provides internal audit services to an audit client. Internal audit services may comprise an extension of the member's or firm's audit service beyond the requirements of Canadian generally accepted auditing standards, assistance in the performance of a client's internal audit activities or outsourcing of these activities. In evaluating any threats to independence, the nature of this service will need to be considered. For this purpose, internal audit services do not include operational internal audit services unrelated to the internal accounting controls, financial systems or financial statements.
- 4.93 *A member, firm or network firm shall not perform an audit engagement of a reporting issuer if, during either the period covered by the financial statements subject to audit or the engagement period, the member, firm, or network firm, or staff of the member, firm or network firm provides an internal audit service to the client or a related entity that relates to the client's or the related entity's internal accounting controls, financial systems or financial statements unless it is reasonable to conclude the results of that service will not be subject to audit procedures during the financial statement audit. In determining whether such a*

*conclusion is reasonable, there is a rebuttable presumption that the results of the internal audit service will be subject to audit procedures.*

- 4.94 Services involving an extension of the procedures required to conduct an audit in accordance with Canadian generally accepted auditing standards would not be considered to impair independence with respect to an audit client provided the staff of the firm or network firm does not act or appear to act in a capacity equivalent to that of a member of the audit client's management.
- 4.95 When the member, firm or network firm provides assistance in the performance of a client's internal audit activities or undertakes the outsourcing of some of the activities, any self-review threat created may be reduced to an acceptable level by ensuring that there is a clear separation between the management and control of the internal audit by audit client management and the internal audit activities themselves.
- 4.96 Performing a significant portion of the audit client's internal audit activities may create a self-review threat and a member, firm or network firm must consider the threats and proceed with caution before taking on such activities. Appropriate safeguards must be put in place. In particular, the member, firm or network firm must ensure that the audit client acknowledges in writing to the member, firm or network firm its responsibilities for establishing, maintaining and monitoring the system of internal controls.
- 4.97 Safeguards that must be applied in all circumstances to reduce any threats created to an acceptable level include ensuring that:
- a) the audit client is responsible for internal audit activities and acknowledges in writing to the member, firm or network firm its responsibility for establishing, maintaining and monitoring the system of internal controls;
  - b) the audit client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;
  - c) the audit client, audit committee or supervisory body approves the scope, risk and frequency of internal audit work;
  - d) the audit client is responsible for evaluating and determining which recommendations of the member, firm or network firm should be implemented;
  - e) the audit client evaluates the adequacy of the internal audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining and acting on reports from the member, firm or network firm; and
  - f) the findings and recommendations resulting from the internal audit activities are reported appropriately to the audit committee or supervisory body.
- 4.98 Consideration must also be given to whether such non-assurance services should be provided only by staff not involved in the audit engagement and with different reporting lines within the firm.

#### **Provision of IT Systems Services**

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

4.100 *A member, firm or network firm shall not perform an audit engagement of a reporting issuer if, during either the period covered by the financial statements subject to audit or the engagement period, the member, firm or network firm or staff of the member, firm or network firm provides financial information systems design or implementation services and the services involve:*

- a) *directly or indirectly operating or supervising the operation of the entity's or a related entity's information systems;*
- b) *managing the entity's or a related entity's local area network;*
- c) *designing or implementing a hardware or software system that aggregates source data underlying the financial statements; or*
- d) *generating information that is significant to the entity's or a related entity's financial statements or other financial information systems taken as a whole;*

*unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during the financial statement audit. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the financial information systems design and implementation services will be subject to audit procedures.*

4.101 In other circumstances, the self-review threat arising from the provision of financial information technology system services is also likely to be too significant to allow for the provision of such services to an audit client unless appropriate safeguards are put in place ensuring that:

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

4.102 Consideration must be given as to whether such non-assurance services should be provided only by staff not involved in the audit engagement or with different reporting lines within the firm.

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

- 4.104 The provision of services in connection with the assessment, design and implementation of internal accounting controls and risk management controls are not considered to create a threat to independence provided that the member or staff of the firm or network firm does not perform management functions.

**Provision of Human Resources Services**

- 4.105 The lending of staff by a member, firm or network firm to an audit client may create a self-review threat when that individual is in a position to influence the preparation of a client's accounts or financial statements. In practice, such assistance may be given, particularly in emergency situations, but only on the understanding that the member's, firm's or network firm's staff will not be involved in:

- a) making management decisions;
- b) approving or signing agreements, cheques, source documents or other similar documents;  
or
- c) exercising discretionary authority to commit the client.

- 4.106 Each situation must be carefully analyzed to identify whether any threats are created and whether appropriate safeguards must be implemented. Safeguards that must be applied in all circumstances to reduce any threats to an acceptable level include:

- a) the member or firm's staff providing the assistance is not given audit responsibility for any function or activity that they performed or supervised during their temporary assignment; and
- b) the audit client must acknowledge its responsibility for directing and supervising the activities of member's or firm's staff.

- 4.107 The recruitment of senior management for an assurance client could also create current or future self-interest, familiarity or intimidation threats. The significance of such threats would depend on factors such as the role of the person being recruited and the nature of the assistance being sought.

- 4.108 The member, firm or network firm could generally provide services such as reviewing the professional qualifications of applicants, advising on their suitability for the post or helping to produce a short-list of candidates for interview, provided the criteria for doing so is established by the assurance client and that all management-related decisions, including who to hire, are retained by the client.

- 4.109 *A member, firm or network firm shall not perform an audit engagement of a reporting issuer if, during either the period covered by the financial statements that are subject to audit or the engagement period, the member, firm, network firm or staff of the member, firm or network firm provides any of the following services to the entity or a related entity:*

- a) *searching for or seeking out prospective candidates for management, executive or director positions;*
- b) *engaging in psychological testing, other formal testing or evaluation programs;*
- c) *undertaking reference checks of prospective candidates for an executive or director position;*

- d) *acting as a negotiator or mediator on the entity's behalf with respect to employees or future employees regarding any condition of employment, including position, status or title, compensation or fringe benefits; and*
- e) *recommending or advising the entity or a related entity to hire a specific candidate for a specific job.*

### **Provision of Legal Services**

- 4.110 Legal services are defined as any services for which the person providing the services must either be admitted to practice before the Courts of the jurisdiction in which such services are to be provided or have the required legal training to practice law. Legal services encompass a wide and diversified range of areas including both corporate and commercial services to clients, such as contract support, litigation, mergers and acquisition advice and support and the provision of assistance to clients' internal legal departments. The provision of legal services by a member, firm or network firm to an audit or review client may create both self-review and advocacy threats.
- 4.111 Threats to independence need to be considered depending on the nature of the service to be provided, whether the service provider is separate from the assurance team and the materiality of any matter in relation to the entities' financial statements. The safeguards set out in paragraph 4.70 may be appropriate in reducing any threats to independence to an acceptable level. In circumstances when the threat to independence cannot be reduced to an acceptable level the only available action is to decline to provide such services or withdraw from the audit engagement.
- 4.112 The provision of legal services to an audit or review client which involve matters that would not be expected to have a material effect on the financial statements are not considered to create an unacceptable threat to independence.
- 4.113 There is a distinction between advocacy and advice. Legal services to support an audit or review client in the execution of a transaction (*e.g.*, contract support, legal advice, legal due diligence and restructuring) may create self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Such a service would not generally impair independence, provided that:
- a) members of the assurance team are not involved in providing the service; and
  - b) in relation to the advice provided, the audit or review client makes the ultimate decision or, in relation to the transactions, the service involves the execution of what has been decided by the audit or review client.
- 4.114 *Acting for an audit or review client in the resolution of a dispute or litigation in such circumstances when the amounts involved are material in relation to the financial statements of the audit or review client would create advocacy and self-review threats so significant no safeguard could reduce the threat to an acceptable level. Therefore, the member, firm or network firm shall not perform this type of service for an audit or review client. If such services are provided, the only course of action is to withdraw from the engagement.*
- 4.115 *Acting for a reporting issuer audit client in any legal service would create advocacy and self-review threats so significant no safeguard could reduce the threat to an acceptable level. Therefore, the member, firm or network firm shall not perform this service for a reporting*

*issuer or a related entity. If such services are provided, the only course of action is to withdraw from the engagement.*

- 4.116 When a member, firm or network firm is asked to act in an advocacy role for an audit or review client in the resolution of a dispute or litigation in circumstances when the amounts involved are not material to the financial statements of the audit or review client, the member, firm or network firm should evaluate the significance of any advocacy and self-review threats created and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:
- a) policies and procedures to prohibit staff assisting the audit client from making managerial decisions on behalf of the client; and
  - b) using professionals who are not members of the assurance team to perform the service.

#### **Provision of Expert Services**

- 4.117 Expert services may include such activities as acting as an expert witness, calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute and assistance with document management and retrieval in relation to a dispute or litigation.
- 4.118 A self-review threat may be created when the expert services provided to an audit and review client include the estimation of the possible outcome and thereby affects the amounts or disclosures to be reflected in the financial statements. The significance of any threat created will depend upon factors such as:
- a) the materiality of the amounts involved;
  - b) the degree of subjectivity inherent in the matter concerned; and
  - c) the nature of the engagement.
- 4.119 The member, firm or network firm must evaluate the significance of the self-review threat created and, if the threat is other than clearly insignificant, safeguards must be considered and applied as necessary to eliminate this threat or reduce it to an acceptable level. Such safeguards might include:
- a) policies and procedures to prohibit staff assisting the audit or review client from making managerial decisions on behalf of the client;
  - b) using professional colleagues who are not members of the assurance team to perform the service; and
  - c) the involvement of others, such as independent experts.
- 4.120 *A member, firm or network firm shall not perform an audit engagement of a reporting issuer, if during either the period covered by the financial statements subject to audit or the engagement period, the member, firm or network firm or staff of the member, firm or network firm provides an expert service for the entity or a related entity, or for a legal representative, for the purpose of advocating the entity's or related entity's interest in a civil, criminal, regulatory, administrative or legislative proceeding or investigation.*

**Provision of Corporate Finance and Similar Activities**

- 4.121 *The provision of corporate finance services, advice or assistance to an assurance client may create advocacy and self-review threats. In the case of certain corporate finance services, the threats to independence created would be so significant that no safeguards could be applied to reduce these threats to an acceptable level. Committing the assurance client to the terms of a transaction or consummating a transaction on behalf of the client would create a threat to independence so significant that no safeguard could reduce the threat to an acceptable level. In the case of an audit or review client, the provision of those corporate finance services referred to above by a member or firm would create a threat to independence so significant no safeguard could reduce that threat to an acceptable level.*
- 4.122 *A member, firm or network firm shall not perform an audit engagement of a reporting issuer if, during either the period covered by the financial statements that are subject to audit or the engagement period, the member, firm or network firm or staff of the member, firm or network firm provides any of the following services to that entity or a related entity:*
- a) promoting, dealing in or underwriting the entity's or related entity's securities;*
  - b) making investment decisions on behalf of the entity or related entity, or otherwise having discretionary authority over such entities' investments;*
  - c) executing a transaction to buy or sell the entity's investments; or*
  - d) having custody of assets of the entity or related entity including taking temporary possession of securities purchased by such entities.*
- 4.123 Other corporate finance services may create advocacy or self-review threats. Examples of such services include assisting a client in developing corporate strategies; assisting in identifying or introducing a client to possible sources of capital that meet the client specifications or criteria; providing structuring advice and assisting a client analyze the accounting effects of proposed transactions. However, safeguards may be available to reduce these threats to an acceptable level. Safeguards that must be considered include:
- a) policies and procedures to prohibit staff assisting the assurance client from making managerial decisions on behalf of that client;
  - b) using professional colleagues who are not members of the assurance team to provide the services; and
  - c) ensuring the member or firm does not commit the assurance client to the terms of any transaction or consummate a transaction on behalf of the client.

***Fees and Pricing*****Fees – Relative Size**

- 4.124 When the total fees generated by an assurance client represent a large proportion of a member's or firm's total fees, the dependence on that client or client group and concern about the possibility of losing the client may create a self-interest threat. The significance of that threat will depend upon factors such as:
- a) the structure of the firm; and
  - b) whether the firm is well established or newly created.

- 4.125 The significance of the self-interest threat must be evaluated and, if that threat is other than clearly insignificant, safeguards must be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:
- a) discussing the extent and nature of fees charged with members of the audit committee or, in the absence of an audit committee, those charged with governance;
  - b) taking steps to reduce dependency on the client;
  - c) external quality control reviews; and
  - d) consulting a third party, such as the member advisor of an Affiliate or a professional colleague.
- 4.126 A self-interest threat may also be created when the fees generated by the assurance client represent a large proportion of the revenue of an individual partner. The significance of this threat must be evaluated and, if the threat is other than clearly insignificant, safeguards must be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:
- a) policies and procedures to monitor and implement quality control of assurance engagements; and
  - b) involving a professional colleague who was not a member of the assurance team to review the work done or otherwise advise as necessary.
- 4.127 *A member or firm shall not perform an audit engagement of a reporting issuer if during either the period covered by the financial statements that are subject to audit or the engagement period, an audit partner who is on the engagement team for either the reporting issuer or a related entity earns or receives compensation based on the audit partner procuring any engagement that is not an assurance engagement from the reporting issuer or a related entity, unless the member or firm has fewer than five audit clients that are reporting issuers and fewer than ten partners.*
- 4.128 A self-interest threat may be created if fees for professional services due from an assurance client remain unpaid for a long time, especially if a significant part is not paid before issuance of the assurance report for the following year. Generally, the payment of such fees must be required before the report is issued. To eliminate or reduce this potential threat, the following safeguards may be applicable:
- a) discussing the level of outstanding fees with the audit committee or, in the absence of an audit committee, those charged with governance; and
  - b) involving a professional colleague who did not take part in the assurance engagement to provide advice or review the work performed.

In addition to the potential threat stated above, the member, firm or network firm must 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 member, firm or network firm to be re-appointed.

### **Pricing**

- 4.129 *A member or firm shall not provide an assurance service for a fee that the member or firm knows is significantly lower than that charged by the predecessor member or firm, or is*

*contained in other proposals for the engagement, unless the member or firm can demonstrate that the provisions listed below have been adhered to:*

- a) demonstrate that appropriate time and qualified staff are assigned to the engagement; and*
- b) applicable assurance standards, guidelines and quality control procedures are being complied with.*

### ***Gifts and Hospitality***

4.130 *Accepting gifts or hospitality from an assurance client may create self-interest and familiarity threats. When a member, firm or a member of the assurance team accepts gifts or hospitality, unless the value is clearly insignificant, the threats to independence cannot be reduced to an acceptable level by the application of any safeguard. Consequently, a member, firm or a member of the assurance team shall not accept such gifts or hospitality.*

### ***Actual or Threatened Litigation***

4.131 When litigation takes place, or appears likely to occur between the member, firm or member of the assurance team and the assurance client, a self-interest or intimidation threat may be created. The relationship between client management and members of the assurance team must be characterized by complete candor and full disclosure regarding all aspects of a client's business operations. The member, firm or members of the assurance team and the client's management may be placed in adversarial positions by litigation, affecting management's willingness to make complete disclosures. As a result, the member or firm may face a self-interest threat. The significance of the threat created will depend upon such factors as:

- a) the materiality of the litigation;
- b) the nature of the assurance engagement;
- c) the stage of the litigation; and
- d) whether the litigation relates to a prior assurance engagement.

4.132 Once the significance of the self-interest threat has been evaluated, the following safeguards must be applied, if necessary, to reduce such threats to an acceptable level:

- a) disclosing to the audit committee or, in the absence of an audit committee, those charged with governance the extent and nature of the litigation;
- b) if the litigation involves a member of the assurance team, removing that staff person from the assurance team; and
- c) involving a professional colleague of the firm who was not a member of the assurance team to review the work done or otherwise advise as necessary.

If such safeguards do not reduce the threat to an appropriate level, the only appropriate action is to withdraw from, or decline to accept the assurance engagement.

## 5. EFFECTIVE DATE

- 5.1 This Standard and the related *Code of Ethical Principles Rules of Conduct* are applicable to assurance and specified auditing procedures engagements when the report is dated on or after December 31, 2004.

Rules R202 to R202.3 of the *CGA Code of Ethical Principles and Rules of Conduct [CEPROC]*, and the related *CGA Independence Standard*, shall take effect:

- a) for an assurance engagement in respect of a particular reporting period of a client, for the first reporting period commencing after the later of December 31, 2004 or December 31 of the year in which it is adopted by a provincial association; and
- b) for any other assurance engagement and an engagement to issue a report of the results of applying specified auditing procedures where the engagement is commenced after the later of December 31, 2004 or December 31 of the year in which it is adopted by a provincial association.

### 5.1.1 Provision of non-assurance services

The non-assurance services referred to in paragraphs 4.63 to 4.123 of the *CGA Independence Standard* do not include a service that has not been completed before the later of January 1, 2005 or January 1 of the year following the year the *CGA Independence Standard* is adopted by a provincial association, where:

- a) there exists on the later of December 31, 2004 or December 31 of the year in which it is adopted by a provincial association, a binding contract for the member or firm to provide the service;
- b) the provision of the service is completed before the later of January 1, 2006 or January 1 of the year following the year in which it is adopted by a provincial association; and
- c) the provision of the service by the member or firm would not have contravened Rule R202.1 of *CEPROC* as it read prior to the later of January 1, 2006 or January 1 of the year following the year in which it is adopted by a provincial association.

### 5.1.2 Prior approval of audit and non-audit services

Paragraph 4.62 of the *CGA Independence Standard* shall not apply to a professional service that has not been completed before the later of January 1, 2005 or January 1 of the year following the year in which it is adopted by a provincial association where:

- a) there exists on the later of December 31, 2004 or December 31 of the year in which it is adopted by a provincial association, a binding contract for the member or firm to provide such service; and
- b) the provision of the service is completed before the later of December 31, 2005 or December 31 of the year in which it is adopted by a provincial association.

### 5.1.3 Employment relationships

The reference to employment in paragraph 4.54 of the *CGA Independence Standard* shall not apply to an employment relationship entered into by a person before the later of January 1,

2005 or January 1 of the year following the year in which it is adopted by a provincial association.

#### 5.1.4 Compensation of audit partners

Paragraph 4.127 of the *CGA Independence Standard* shall not apply to the compensation of an audit partner in respect of the fiscal period of the audit partner's firm that includes the later of December 31, 2004 or December 31 of the year in which it is adopted by a provincial association.

#### 5.1.5 Audit partner rotation

Notwithstanding the requirements of paragraph 4.61 of the *CGA Independence Standard*:

- a) a lead engagement partner may continue in that role for a particular client up to and including the second fiscal year of the client commencing after the later of December 31, 2004 or December 31 of the year in which it is adopted by a provincial association, notwithstanding that such partner has completed five or more years in that role, or in the role of engagement quality control reviewer, before that second fiscal year;
- b) an engagement quality control reviewer may continue in that role for a particular client up to and including the third fiscal year of the client commencing after the later of December 31, 2004 or December 31 of the year in which it is adopted by a provincial association, notwithstanding that such partner has completed five or more years in that role, or in the role of lead engagement partner, before that third fiscal year;
- c) a partner referred to in paragraph 4.61(b) of the *CGA Independence Standard* may continue in the particular role for up to seven years after the later of December 31, 2004 or December 31 of the year in which it is adopted by a provincial association notwithstanding that such partner has completed seven or more years in that role before the fiscal year of the particular client commencing after December 31, 2004 or December 31 of the year in which it is adopted by a provincial association;
- d) a member may commence the role of lead engagement partner for a particular client prior to the end of the client's second fiscal year commencing after the later of December 31, 2004 or December 31 of the year in which it is adopted by a provincial association, and may continue in that role for five years, notwithstanding the number of years, if any, that the member was previously the engagement quality control reviewer for the particular client.