

Ethical Standard Policy



 **AUDIT SCOTLAND**

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Ethical Standard Policy

Foreword

Our vision is to be a world-class audit organisation that improves the use of public money. In the current challenging and complex environment for the public sector in Scotland, independent, objective and authoritative public audit helps to support a strong and effective system of financial accountability and transparency.

In order to deliver world-class audit and ensure continued trust in our work, we need to apply the highest professional and ethical standards. The Scottish public sector audit model provides a high level of safeguards to our independence that go above and beyond the requirements of the Financial Reporting Council's Ethical Standard. These include:

- independent appointment of auditors to ensure the auditor is free from any potential or perceived conflict of interest or other pressure that might compromise their judgement
- rotation of auditors every five to seven years to minimise any 'familiarity' threats to independence
- arrangements to control non-audit services through approval by Audit Quality and Appointments to minimise 'self-review' and other threats to independence

We have reviewed the FRC's Ethical Standard and chosen to enforce the highest level of protection to our audit work because we believe that the independence of the auditor is critical to high quality audit. However, high quality audit cannot be assured through rules and standards alone. It relies on each and every one of us embedding ethical principles in our day to day work.

Kenneth Oliver
Executive Director of Innovation and Quality; and Ethics Partner

Introduction

1. The Financial Reporting Council's Ethical Standard (December 2019 edition) ("the Standard") specifies the ethical requirements of auditors. Audit Scotland adopts the principles in the standard in common with all the national audit agencies in the UK. Compliance with the Standard also represents compliance with the parts of the International Ethics Standards Board for Accountants' (IESBA) Code of Ethics for Accountants covering audit work that has been adopted by most UK accountancy institutes (see appendix 1) and therefore applicable to a significant number of Audit Scotland staff.

2. The principles of the Standard apply to all our work. Where sections of the standard need specific interpretation to our work (highlighted in boxes throughout this application guidance), this guide explains how they are applied and, where a policy is explicitly required, sets out that policy.

However, you should be aware that this guide covers only those requirements where application guidance is necessary; it does not cover all the requirements of the Standard – the full standard is available on Sharepoint, and all staff are expected to be familiar with its requirements.

3. All staff are required to adhere to Audit Scotland's Staff Code of Conduct. You should read this application guide of the Standard in conjunction with the Code of Conduct and Audit Scotland's Counter Fraud Policy.

4. If you are in any doubt about the application of the Standard in any particular circumstances, you should discuss it with your line manager; a member of the Executive Team; the Ethics Partner; or the Deputy Ethics Partner.

5. This policy has been presented to reflect the revised Ethical Standard issued by the FRC, which came into effect on 15 March 2020. Should any part of the Standard be revised in the future by the FRC prior to this application guide being updated, the revisions will come into force in line with their effective date.

6. The Standard is in two parts:

- **Part A** - sets out the overarching principles of integrity, objectivity and independence, together with supporting ethical provisions. These establish a framework of ethical outcomes to be met.
- **Part B** - sets out specific requirements relevant to certain circumstances that may arise which are designed to assist in meeting the ethical outcomes. The following application guidance principally addresses some of the specific requirements.

7. The Standard refers to the role of the Engagement Partner, and in some instances professional guidance to the Standard refers to an Engagement Lead. Any such references in this Policy are to be read as Appointment Lead, which is the term used in the Code of Audit Practice.

Section 1 - General requirements and guidance

Introduction

8. Section one of the Standard sets out the general requirements for auditors to act with integrity, objectivity and independence and establishes some of the framework for compliance with other requirements.

9. Most of our audits are carried out under appointment by either the Auditor General or the Accounts Commission. This provides a strong safeguard against the threats to integrity, objectivity and independence that all auditors must consider before accepting an audit appointment. The independent appointment process means that Audit Scotland auditors cannot refuse an appointment. Where the auditor identifies a threat that would result in an equivalent private sector audit being refused, the auditor must consider whether the threats are of such significance that they should be reported formally to the audited body, the Auditor General for Scotland or the Accounts Commission, or to the Scottish Parliament.

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

Compliance

Paragraph 1.1

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

Paragraph 1.2

The firm shall establish appropriate and effective organisational and administrative arrangements:

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

11. All Audit Scotland staff must:

- comply with the staff Code of conduct and any further guidance in this application guide
- notify any potential conflicts of interest to the Ethics Partner or Deputy Ethics Partner, and
- make an annual declaration of compliance with the staff Code through the Fit and Proper self-assessment form.

Ethics Partner

Paragraph 1.12

The senior management of the firm shall designate a partner in the firm possessing the necessary seniority, relevant experience, authority and leadership levels (the 'Ethics Partner') as having responsibility for ensuring the firm's compliance with supporting ethical provision A1.1.

12. Audit Scotland has appointed an Ethics Partner and Deputy Ethics Partner.

Threats to Integrity, Objectivity and Independence

Paragraph 1.28

When complying with supporting ethical provisions A2.1–A2.3, conditions and relationship that could give rise to threats to the integrity, objectivity or independence of the firm or covered persons are communicated to the appropriate person, having regard to the nature of the threats and to the part of the firm and the identity of any person involved.

13. All threats to integrity, objectivity or perceived loss of independence must be reported to the Ethics Partner or Deputy Ethics Partner. This requirement applies to all types of audit work.

14. Paragraphs I14 and A2 of the Standard state that there should be consideration of whether the ethical outcomes required by the overarching principles and supporting ethical provisions have been met should be evaluated by reference to the perspective of an objective, reasonable and informed third party. All auditors should consider the 'Third Party Test' when considering any potential independence or ethical threats.

Paragraph A2.1

The firm and each covered person, shall ensure (in the case of a covered person, insofar as they are able to do so) that the independence of the firm and each covered person is not compromised with respect to each entity relevant to the engagement. This includes ensuring that the firm and each covered person is not involved in management decision-taking.

15. Audit Scotland's staff must not take decisions that are the responsibility of management of the audited body or its affiliates. An affiliate is a member of the same group as the audited body. The audited body may have control or significant influence over the affiliate and a financial interest in the affiliate or may be controlled by the affiliate.

Paragraph 1.33

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

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

16. The Auditor General or Accounts Commission appoint auditors based on advice from Audit Quality and Appointments (AQA) so the risk to independence in relation to accepting audits is managed by the Auditor General or Accounts Commission's appointments. AQA applies the Ethical Standard when providing advice on audit appointments to the Auditor General and Accounts Commission. Auditors are therefore not required to identify threats to objectivity, including perceived loss of independence when considering whether to accept or retain an audit appointment.

17. For agreement audits such as EAFA, audit staff should document any threats to integrity, independence and objectivity and should consult AQA before initial acceptance of the engagement.

18. Audit Scotland normally only provides audit and audit-related services to audited bodies. Occasionally auditors may be asked to undertake non-audit services for their audited bodies; auditors must obtain prior approval before undertaking this work.

Identification and Assessment of Safeguards

Paragraph 1.39

If the engagement partner identifies threats to the integrity or objectivity of the firm or covered persons, including any that could compromise independence, they shall identify and assess the effectiveness of the available safeguards and apply such safeguards as are sufficient to eliminate the threats or reduce them to a level where independence would not be compromised.

Paragraph 1.43

The firm shall establish policies and procedures which set out the circumstances in which those additional requirements listed in paragraph 1.42 that apply to public interest entities or to listed entities or both are applied to other engagements.

19. All threats to integrity, objectivity or perceived loss of independence must be reported to the Ethics Partner or Deputy Ethics Partner.

Overall Conclusion

Paragraph 1.50

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

20. If the engagement lead on an audit appointment or equivalent for a performance audit is unable to conclude that any threats to integrity, objectivity and independence have been addressed in accordance with the Ethical Standard, the engagement lead must refer the threat to the Ethics Partner or Deputy Ethics Partner for resolution.

Communication with those Charged with Governance

Paragraph 1.54

The engagement partner shall ensure that those charged with governance of each entity relevant to an engagement ... are appropriately informed on a timely basis of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons.

21. Auditors must communicate the information required by paragraph 1.54 to those charged with governance through the annual audit plan, the annual audit report and other relevant communications.

Paragraph 1.58

In the case of public interest entities, and listed entities, relevant to an engagement, the engagement partner shall ensure that the audit committee is provided with:

- (a) a written disclosure of relationships (including the provision of non-audit / additional services) that may bear on the integrity, objectivity or independence of the firm or covered persons. This shall have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties, and the threats to integrity or objectivity, including those that could compromise independence, that these create. It shall also detail any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable the integrity, objectivity and independence of the firm and each covered person to be assessed;
- (b) details of non-audit / additional services provided and the fees charged in relation thereto;
- (c) written confirmation that the firm and each covered person is independent;
- (d) details of any inconsistencies between this Ethical Standard and the policy of the entity for the provision of non-audit / additional services by the firm and any breach or apparent breach of that policy;
- (e) details of any breaches of the requirements in this Ethical Standard, and of any safeguards applied and actions taken by the firm to address any threats to independence; and
- (f) an opportunity to discuss independence issues.

22. The requirements of paragraph 1.58 apply to all audits. Auditors must communicate the information required by paragraph 1.58 to those charged with governance through the annual audit plan, the annual audit report and other relevant communications.

Documentation

Paragraph 1.63

The firm shall document in the engagement working papers all significant threats to the integrity or objectivity, including any that could impair independence, of the firm and all covered persons as well as the safeguards applied to mitigate those threats and why they mitigate the threats.

Paragraph 1.64

The engagement partner shall ensure that their consideration of the integrity, objectivity, and independence of the firm and covered persons is appropriately documented on a timely basis.

23. The audit work programmes must be followed to ensure sufficient documentation of the consideration of potential threats; conclusions; and related safeguards. The engagement lead is responsible for ensuring there is sufficient documentation in accordance with the Standard.

Section 2 – Financial, Business, Employment and Personal Relationships

Introduction

24. Section 2 of the Standard sets out the requirements concerning relationships with audited bodies including transfers of staff in either direction.

25. All staff are required to complete an annual Fit and Proper self-assessment to declare any potential threats from relationships with audited bodies so that appropriate safeguards can be put in place.

26. The guidance below sets out the key requirements of the Standard and how they are applied in Audit Scotland. The requirements relate to loans, employment, secondments and staff joining or leaving Audit Scotland from or to a public-sector body in Scotland.

27. Where a member of staff of Audit Scotland has left, or has applied for a role, to join an audited body in a senior position, there is a potential threat to the conduct of audit work. These threats and how Audit Scotland manages them are detailed below.

Financial Considerations

Paragraph 2.4

The firm, each of the firm's key audit partners and each of the firm's directly involved covered persons for any engagement, and any persons closely associated with the firm or any such partner or covered person, shall not:

- (a) hold any material financial interest (other than an indirect financial interest held through a diversified collective investment scheme) in, or engage in any transaction in, any financial instrument of any entity relevant to an engagement in the area of activity in which they (or in the case of a person closely associated, the area of activity in which the firm, key audit partner or covered person with whom they are closely associated) are involved relating to engagements; or
- (b) hold any financial interest, other than an indirect financial interest held through a diversified collective investment scheme, in:
 - (i) any entity relevant to an engagement for which they are a directly involved covered person; or
 - (ii) an entity which is an affiliate of such an entity; or
 - (iii) any other entity otherwise related to such an entity in circumstances where holding such a financial interest may cause, or may be generally perceived as causing, a conflict of interest; or, if a person holds such a financial interest, they shall be excluded from any role by virtue of which they would be a covered person for any such engagement.

28. No Audit Scotland staff may hold a financial interest in a financial instrument issued by any body where the auditor is appointed by the Auditor General or Accounts Commission, except for membership of a Pension Fund. Financial instruments are assets that can be traded, such as shares and bonds.

Loans and Guarantees

Paragraph 2.23

Covered persons and persons closely associated with them shall not accept a loan from, or have their borrowings guaranteed by, the entity relevant to the engagement, or the affiliates of such an entity, unless:

- (a) the entity is a bank or similar deposit taking institution;
- (b) the loan or guarantee is made in the ordinary course of business on normal business terms; and
- (c) the loan or guarantee is not material to the entity

Where a covered person or persons closely associated with them have accepted a loan from, or have their borrowings guaranteed by an entity relevant to an engagement, or the affiliates of such an entity, the covered person shall withdraw from the engagement where the loan falls into significant arrears.

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

Management Role with an Entity Relevant to an Engagement

Paragraph 2.35

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

30. Audit Scotland will not employ, as financial audit staff, individuals who are also employed by an audited body.

31. Staff may be employed to work on other audit work, such as national performance audits, provided that the work is not focused on their other employer. For example, working on a Best Value assurance report of the employee's council would not be acceptable.

32. Any incidental work relating to the other employer (e.g. preparing a report from a national survey which includes the other employer) must be subject to specific review by a more senior member of staff.

Loan Staff Assignments

Paragraph 2.36

A firm shall not enter into an agreement with an entity relevant to an engagement, or with the affiliates of such an entity, to provide any partner or employee to work for a temporary period as if that individual were an employee of any such entity or its affiliates. An exception applies: in respect of staff employed by a UK national audit agency, in a role with no management responsibilities; when the role to be filled in an entity relevant to an engagement has no line management or management responsibilities; for a period of no longer than three months²⁶; and where the service to be provided would not be prohibited by this Ethical Standard.

²⁶ Or no longer than six months for a staff member from a national audit agency employed on a training contract

33. The requirements at paragraph 2.36 cover staff on secondment to audited bodies. Secondments must be considered and planned in accordance with the Secondment Policy. Audit Scotland staff can only be seconded to an audit where:

- the secondment period is 3 months or less (or 6 months or less in the case of trainees)
- the member of staff being seconded has no management responsibilities in Audit Scotland and
- the role seconded to involves no management or line management responsibilities

34. Although the Ethical Standard does not cover the secondment of staff from audited bodies to Audit Scotland, similar principles apply. Seconded to audit teams should not work on the audit of the body from which they are seconded. The Ethics Partner must authorise any departure from this policy, due to for example the previous role of the secondee.

- 35.** Seconded to the Performance Audit and Best Value Group (PABV) may work on other audit work, such as national performance audits, provided that the work is not focussed on their other employer.
- 36.** Any incidental work relating to the other employer (e.g. preparing a report from a national survey which includes the other employer) must be subject to specific review by a more senior member of staff.

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

Paragraph 2.39

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

(a) for all such engagements:

- (i) senior members of the engagement team to notify the firm of any situation involving their potential employment with any such entity; and
- (ii) other members of the engagement team to notify the firm of any situation involving their probable employment with any such entity; and
- (iii) all partners in the firm to notify the firm of any situation involving their potential employment with any such entity; and
- (iv) any other employee of the firm and any other natural person whose services are placed at the disposal of or under the control of the firm, where such employee or other person is personally approved as a statutory auditor under relevant legislation, to notify the firm of any situation involving their probable employment with any such entity;

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

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

- 37.** 'Partner' is defined as Audit Director and above (Band 4).
- 38.** Staff in Band 4 must notify the Ethics Partner of any application for any job in a public body subject to audit by auditors appointed by the Auditor General or Accounts Commission. The Ethics Partner must notify the Auditor General of any application for any such jobs.
- 39.** All other members of staff must notify the Ethics Partner of any application to a relevant audited body.
- 40.** 'Any entity relevant to an engagement', or 'a relevant audited body' is defined as any body which they have audited in the previous 12 months.
- 41.** Staff carrying out audit work at the specific body applied to must stop working on the audit immediately pending the outcome of the application/offer and, if successful, must not return to that work. Staff who notify potential employment but are not in the event selected must obtain the Ethics Partner or Deputy Ethics Partner approval to return to the audit; such approval will be provided whenever and wherever it is reasonable and practicable to do so.
- 42.** All work carried out on any audit activity at the audited body by the resigning member of staff must be reviewed by a more senior member of staff.

Paragraph 2.45

Where a partner, or another person (including a person whose services are at the disposal or under the control of the firm) who is personally approved as a statutory auditor as described in paragraph 2.40, is appointed as a director, a member of the audit committee or body performing equivalent functions, or to a key management position with an entity relevant to an engagement, having previously been a covered person:

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

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

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

(ii) in the case of another person, a one-year period;

commencing when the person ceased to be a covered person, or until the person ceases employment with the entity, whichever is the sooner.

43. Audit Quality and Appointments will normally recommend the Auditor General or Accounts Commission transfer that audit appointment to a firm where an individual in Band 4 leaves Audit Scotland to join an audited body as a director or in a key management position and they carried out the role of audit engagement partner or other relevant partner role at that body.

44. The Ethics Partner or Deputy Ethics Partner must put in place stringent safeguards if transfer to a firm is not possible (such as in the case of the Scottish Government or other audits where the Auditor General signs the independent auditor's report) to ensure that there is no loss of independence, e.g. independent review by another director or a firm.

45. Audit Quality and Appointments will take the circumstances of the member of staff leaving into account if the next audit appointments are made within two years of the person leaving and will normally not recommend reappointment of Audit Scotland within a two-year period.

46. Audit Quality and Appointments will review the composition of the audit team where any other former member of the audit team of an audited body leaves Audit Scotland and within two years joins the audited body as a director or in a key management position.

Family Members Employed by an Entity Relevant to an Engagement

Paragraph 2.51

Where a covered person, or any partner in the firm, becomes aware that a person closely associated with them, or a close family member, is employed by an entity relevant to the engagement and that person is in a position to exercise influence on the accounting records or financial statements or other subject matter information or subject matter of such an engagement, that covered person or that partner shall either:

- (a) in the case of a person closely associated with them being employed by the entity in such a position, be excluded from any role in which they would be a covered person; or
- (b) in the case of a close family member of a covered person or any close family member of any partner in the firm, report the matter to the engagement partner to take appropriate action. If it is a close family member of the engagement partner or if the engagement partner is in doubt as to the action to be taken, the engagement partner shall resolve the matter in consultation with the Ethics Partner/Function.

47. From time to time, it will be the case that some Audit Scotland staff have family members who are employed by public bodies. Given the wide range of circumstances that may exist, each case is dealt with on its merits. However, the general policy is that the closer to the subject matter of audit work that the family member is employed (e.g. in a finance role), the more likely it is that the member of staff should not take part in the audit. Similarly, the more senior the member of staff and/or their family member, the greater the perceived threat to independence and objectivity.

48. It is unlikely that family members employed in roles such as teachers, doctors or nurses would normally create any threat to independence of staff members.

49. Staff engaged on audit work that covers several audited bodies need to be particularly vigilant in this area. Members of staff should discuss any such relationships with their line manager and if appropriate the Ethics Partner or Deputy Ethics Partner.

Governance Role with an Entity Relevant to an Engagement

Paragraph 2.53

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

- (a) as an officer or member of the board of directors of an entity relevant to an engagement of the firm;
- (b) as a member of any subcommittee of that board; or
- (c) in such a position in an entity which holds directly or indirectly more than 20% of the voting rights in the entity relevant to an engagement, or in an entity in which the entity relevant to such an engagement holds directly or indirectly more than 20% of the voting rights.

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

- Example 1 – an engagement lead on the audit of a council is offered the role of treasurer or chair to a Citizens' Advice Bureau which is 40% funded by that council and the funding is discretionary. This could create a perception of a conflict between the roles and must be avoided.
- Example 2 – membership of a school board – while the school will be funded by the council, it is required to provide education as a statutory service. The likely influence of a member of a school board on the level of funding is negligible and the potential for conflict of interest is minimal.

51. Staff should not seek board membership of bodies where the Auditor General or the Accounts Commission appoint the auditor as this can limit flexibility in making audit appointments or in the deployment of staff. Any offers for such positions must be agreed with the Ethics Partner.

Employment with the Firm

Paragraph 2.57

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

52. Paragraph 2.57 applies in full for financial audits. If the individual joining Audit Scotland has ASG management responsibility they must not be involved in the audit of their former employer, and the audit must be subject to an independent review for the first two years irrespective of the size of the body.

53. An individual joining PABV from a management position must not have any involvement in audit work or studies which focus on their former employer for a period of two years after joining. Any incidental work must be subject to specific review by a more senior member of staff.

Family and Other Personal Relationships

Paragraph 2.62

The firm shall establish policies and procedures that require:

- (a) partners and professional staff members to report to the firm any persons closely associated with them, any close family, and other personal relationships, where any of those persons is involved with an entity relevant to an engagement of the firm, where the partner or professional staff member considers that the relationship might create a threat to integrity or objectivity or may compromise independence;
- (b) the relevant engagement partners to be notified promptly of any information reported by partners and other professional staff members as required by paragraph (a).

54. All staff must complete an annual Fit and Proper self-assessment form. This requires staff to immediately report circumstances that would negatively impinge on their independence to their line manager and where necessary to the Ethics or Deputy Ethics Partner.

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

Introduction

55. Section 3 of the Standard sets out the requirements concerning long association with an audit.

56. Audit Scotland adopts robust limits on how long any auditor spends on an audit, not just senior staff as required by the Ethical Standard. Audit Services Group records all staff's involvement in audits on an audit rotation database. In addition, the five year tender includes rotation of about half of Audit Services' audits to the private firms.

General Requirements

Paragraph 3.2

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

57. Business groups monitor the length of time that staff work on audits with a view to key senior staff not normally staying on the same audit for more than five years in the same role.

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

Key Audit Partners and Engagement Partners

Paragraph 3.11

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

- (a) no one shall act as engagement partner for more than five years, this includes time spent participating in an engagement, where an audit engagement has moved between firms; and
- (b) anyone who has acted as the engagement partner for a particular entity for a period of five years, shall not subsequently participate in the engagement until a further period of five years has elapsed; and
- (c) on completing their rotation, the engagement partner, shall not continue to have significant or frequent interaction with senior management or with those charged with governance of the entity they have previously audited until the cooling off period has elapsed.

Paragraph 3.14

3.14 When an entity becomes a public interest entity or another listed entity, the length of time the engagement partner has served the entity in that capacity is taken into account in calculating the period before the engagement partner is rotated off the engagement team. However, where the engagement partner has already served for four or more years, that individual may continue to serve as the engagement partner for not more than two years after the entity becomes such a public interest entity or another listed entity.

Paragraph 3.15

3.15 In circumstances where the audit committee (or equivalent) of an entity that is a public interest entity or another listed entity decide that a degree of flexibility over the timing of rotation is necessary to safeguard the quality of the engagement and the firm agrees, the engagement partner may continue in this position for an additional period of up to two years, so that no longer than seven years in total is spent in the position of engagement partner. An audit committee and the firm may consider that such flexibility safeguards the quality of the engagement, for example, where:

- substantial change has recently been made or will soon be made to the nature or structure of the entity's business; or
- there are unexpected changes in the senior management of the entity; or
- the firm, having taken all reasonable succession planning steps, has no other partners with the necessary knowledge and experience who are able to take over as engagement partner.

In these circumstances alternative safeguards are applied to reduce any threats to a level where it is not probable that an objective, reasonable and informed third party would conclude the integrity, objectivity or independence of the firm or covered persons are compromised. Such safeguards may include ensuring that an expanded review of the engagement work is undertaken by the engagement quality control reviewer or a partner with relevant expertise, who is not involved in the engagement.

59. Paragraph 3.11 applies to all bodies. Although Audit Scotland applies the five year rotation as standard, where circumstances require a degree of flexibility over the timing of rotation to safeguard the quality of the audits, this may be extended for an additional period of up to two years, so that no longer than seven years in total is spent as engagement partner.

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

Paragraph 3.20

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

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

The policies and procedures established by the firm shall include, in the application of the requirements in sub paragraphs (a) to (c)(iii) any time spent participating in an engagement where an audit engagement has moved between firms.

60. Paragraph 3.20 applies to all bodies.

61. The engagement lead for the Scottish Government audit, where the audit opinion is signed by the Auditor General, is considered to be the Audit Director, who is subject to the time limits.

62. The 'Key partner involved in the engagement' is an audit partner involved at group level and responsible for key decisions or judgements on significant matters such as on significant subsidiaries or divisions of the audited body or on significant risk factors that relate to that body.

Other Partners and Staff Involved in the Engagement in Senior Positions

Paragraph 3.21

In the case of public interest entities and other listed entities, the engagement partner shall review the safeguards put in place to address the threats to the objectivity and independence of the person or persons conducting the engagement arising where partners and staff have been involved in the engagement, or been responsible for the relationship between the audit firm and the entity, including periods prior to the firm's appointment as auditor, in senior positions for a continuous period longer than seven years and shall discuss those situations with the Ethics Function / Partner.

63. All staff will normally be limited to five years on any one audit, except in exceptional circumstances where the Ethics Partner may allow the limit to be extended by up to two years.

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

Introduction

64. Section 4 of the Standard sets out the requirements concerning fees and remuneration. Fees for Audit Scotland's audits are set by AQA independently of auditors. This provides a strong control against threats to independence in combination with the independent appointment.

Fees

Paragraph 4.1

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

65. Audit engagement leads must assign sufficient staff with appropriate skills for the work to be carried out in accordance with applicable standards, irrespective of the audit fee, budget or planned timetable.

Paragraph 4.5

Fees for the provision of engagements, non-audit and audit-related services to an entity relevant to an engagement, its UK parent undertaking and any worldwide controlled undertaking shall not be contingent fees.

66. Audit Scotland does not undertake any work on a contingent fee basis.

Paragraph 4.24

Where it is expected that the total fees for services receivable from a non-listed entity that is not a public interest entity and its subsidiaries relevant to a recurring engagement by the firm will regularly exceed 15% of the annual fee income of the firm or, where profits are not shared on a firm-wide basis, of the part of the firm by reference to which the engagement partner's profit share is calculated, the firm shall not act as the provider of the engagement for that entity and shall either resign or not stand for reappointment, as appropriate

Paragraph 4.27

Where it is expected that the total fees for services receivable from a public interest entity or other listed entity and its subsidiaries relevant to a recurring engagement by the firm will regularly exceed 5% of the annual fee income of the firm or the part of the firm by reference to which the engagement partner's profit share is calculated, but will not regularly exceed 10%, the engagement partner shall disclose that expectation to the Ethics Partner/Function and to those charged with governance of the entity, including the audit committee where there is one, and discusses with both the threat to integrity, objectivity and independence of the firm and covered persons and whether safeguards need to be applied to eliminate or reduce the threat to a level where independence would not be compromised.

Paragraph 4.51

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

67. The fees receivable from the audit of the Scottish Government and EAFA are above 5% of the total annual audit fee. The Scottish Government group of audits is the only audit which normally has fees exceeding 10% of ASG's total fee income. However, each subsidiary is audited independently and the engagement lead for the consolidated account has no direct influence, in that role, over the audit judgements for the subsidiaries.

68. The threats to objectivity envisaged by the standard are fully mitigated because these audit appointments are made independently of the body by the Auditor General and consequently this requirement does not apply.

Remuneration and Evaluation Policies

Paragraph 4.36

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

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

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

Gifts and Hospitality

Paragraph 4.40

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

Paragraph 4.43

The firm shall establish policies on the nature and value of gifts, favours and hospitality that may be accepted from and offered to other entities, which are likely to subsequently become an entity relevant to an engagement and issue guidance to assist partners and staff to comply with such policies, including on events that would trigger the application of the policy.

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

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

Introduction

71. Section 5 of the Standard sets out the requirements for providing services to audited bodies in addition to the core audit work. Audit Scotland's focus is on financial audit and there is no incentive to conduct non-audit services. Any such work will be carried out only if requested and can be accepted only with approval from AQA.

72. Paragraphs 5.1 to 5.34 of section 5 set out the general approach to providing non-audit services to audited bodies, and additional services to bodies which they may not audit but for which they undertake other public interest assurance services. This approach is applicable irrespective of the nature of the non-audit/additional services in a given case.

73. Paragraphs 5.39 to 5.127 of section 5 illustrate the application of the general approach to a number of common non-audit/additional services.

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

General Approach to Non-audit / Additional Services

Paragraph 5.10

The firm shall require others within the firm, when considering whether to provide a non-audit / additional service to an entity relevant to an engagement, or to any of its affiliates, to communicate details of the proposed non-audit / additional service to the engagement partner who considers the implications for the integrity, objectivity and independence of the firm and covered persons before provision of the non-audit / additional service is accepted.

75. Any non-audit services carried out by ASG must be arranged through the audit engagement lead. All proposed non-audit services must first be approved by the Ethics Partner, and then by AQA. Requests should be made in writing to AQA and should be accompanied by express assurance from the auditor that the Engagement Partner has reviewed the proposed work and that they do not consider that it represents a conflict with the firm's role as external auditor, in particular a self-review threat.

76. AQA will make its decision on any request having regard to the FRC Ethical Standard currently in force and may consult Audit Scotland's Ethics Partner.

77. All staff need to be aware of the possibility in relation to any improvement work or advice and must discuss any proposed work with the audit engagement lead.

78. Audit Scotland staff do not provide additional services to bodies that are not audited.

Evaluation of specific non-audit services and additional services

79. Paragraphs 5.43 to 5.127 give the following examples of non-audit services where extreme care is required: Internal audit services; Information technology services; Valuation services; Actuarial valuation services; Tax services; Litigation support services; Legal services; Recruitment and remuneration services; Corporate finance services; Transaction related services; Restructuring services; and Accounting Services. The requirements of paragraph 5.43 to 5.127 apply to all audits.

Audit related services

Paragraph 5.36

Audit related services are:

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

80. Audit related services are those non-audit services that are largely carried out by the engagement team and where the work involved is closely related to the financial audit.

81. Each type of audit related services may be undertaken. The type of audit related service most likely to be undertaken is work on the certification of grant claims. Auditors must seek approval from the Ethics Partner, and then AQA.

Appendix 1

Application of IESBA Ethics Code to UK Accountancy Bodies

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

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

84. Information on each institute's ethics code is as follows

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