



# Guidance to the ICAS Code of Ethics:

Objectivity - Financial  
interests in, or relationships  
with, clients

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# 1. Introduction

ICAS has published this guidance paper - 'ICAS Code of Ethics: Objectivity – Financial interests in, or relationships with, clients' - to provide assistance to ICAS Members on how to ensure adherence to the fundamental ethics principle of objectivity.

There are clear threats to objectivity when a CA or member firm has financial interests in and/or relationships (business, family or other personal) with their client. There will only be very limited circumstances when those threats can be reduced to an acceptable level. This paper discusses some factors that a professional accountant might need to consider when making an assessment as to whether adherence to the fundamental ethics principle of objectivity can be met and provides case studies in the Appendix by way of illustration.

## 2. ICAS Code of Ethics - Objectivity

The ICAS Code of Ethics ("the Code") is substantively based on the Code of Ethics published by the International Ethics Standards Board for Accountants (IESBA). The five fundamental ethics principles enshrined in the Code are defined in Section 110 as follows:

- (a) Integrity - to be straightforward and honest in all professional and business relationships.
- (b) Objectivity – to exercise professional or business judgment without being compromised by:
  - (i) Bias;
  - (ii) Conflict of interest; or
  - (iii) Undue influence of, or undue reliance on, individuals, organisations, technology or other factors
- (c) Professional competence and due care – to:
  - (i) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and relevant legislation; and
  - (ii) Act diligently and in accordance with applicable technical and professional standards.
- (d) Confidentiality - to respect the confidentiality of information acquired as a result of professional and business relationships.
- (e) Professional Behaviour – to:
  - (i) Comply with relevant laws and regulations;
  - (ii) Behave in a manner consistent with the profession's responsibility to act in the public interest in all professional activities and business relationships; and
  - (iii) Avoid any conduct that the professional accountant knows or should know might discredit the profession.

Objectivity is further described at subsection 112 of the Code as follows:

### "SUBSECTION 112 – OBJECTIVITY

"R112.1 A professional accountant shall comply with the principle of objectivity, which requires an accountant to exercise professional or business judgement without being compromised by:

- (a) Bias;
- (b) Conflict of interest; or
- (c) Undue influence of, or undue reliance on, individuals, organisations, technology or other factors.

R112.2 A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgement regarding that activity."

In Section 120, the Code provides a conceptual framework that professional accountants shall apply to ensure adherence to the fundamental principles. The conceptual framework requires professional accountants to:

- (a) identify threats to compliance with the fundamental principles;
- (b) evaluate the threats identified; and
- (c) address the threats by eliminating them, or reducing them to an acceptable level by applying safeguards.”

The Code also discusses in Section 120 the requirement for professional accountants to have an inquiring mind; to exercise professional judgement; and to apply the ‘reasonable and informed third party test’.

The Code goes on to explain that:

“Having an inquiring mind involves: (a) Considering the source, relevance and sufficiency of information obtained, taking into account the nature, scope and outputs of the professional activity being undertaken; and (b) Being open and alert to a need for further investigation or other action.” (paragraph 120.5 A1)

and

“Professional judgement involves the application of relevant training, professional knowledge, skill and experience commensurate with the facts and circumstances, taking into account the nature and scope of the particular professional activities, and the interests and relationships involved.” (paragraph 120.5 A4)

The ‘reasonable and informed third party test’ is discussed in more detail below.

### 3. Section 370 – Objectivity – All services

Section 370 of the Code focuses on ‘Objectivity – All Services’ stating at paragraph R370.3 that “a professional accountant shall determine when providing any professional service whether there are threats to compliance with the fundamental principle of objectivity resulting from having interests in, or relationships with, a client or its directors, officers or employees.” The section contains requirements for professional accountants when there are any self-interest and familiarity threats to compliance with the fundamental principle of objectivity which could result from:

- the professional accountant having business, family or other personal relationship(s) with a client or any officer or employee of the client;
- a firm, or any principal of the firm, or any of that individual’s immediate family, directly or indirectly, making a loan to or accepting a loan from a client.
- a firm, any principal of the firm, or any of that individual’s immediate family, directly or indirectly, guaranteeing a loan to a client or having a borrowing guaranteed by a client;
- the professional accountant having beneficial interests in shares, or other investments, in a client.

In particular, paragraph R370.5 states the following:

“The existence of threats to objectivity when providing any professional service will depend upon the particular circumstances of the engagement and the nature of the work that the professional accountant is performing.

In particular objectivity might be subject to self-interest or familiarity threats in the following circumstances.

(a) Family, other personal or business relationships

Objectivity might be subject to a self-interest threat where a mutual business interest exists with a client or any officer or employee of the client. In such circumstances, safeguards shall be applied and adequate disclosure of any conflict of interest shall be made to all relevant parties.

Professional accountants who hold office in a client company or have a comparable business relationship with a client, shall be aware of the dangers inherent in seeking to combine such a role with that of business adviser or other professional service having regard to the self-interest threat to their objectivity. In such circumstances, professional accountants shall be aware of the distinctive nature of each of the roles in which they are professionally engaged, and employ safeguards, including disclosure where appropriate.

(b) Loans

Objectivity might be subject to a self-interest threat if a firm, any principal of the firm, or any of that individual's immediate family, directly or indirectly, makes a loan to or accepts a loan from a client. Likewise, objectivity might be subject to a self-interest threat if a firm, any principal of the firm, or any of that individual's immediate family, directly or indirectly, guarantees a loan to a client or has a borrowing guaranteed by a client. In any such scenario the threat shall be carefully considered prior to the loan or guarantee being made or accepted.

Loans and Guarantees with a Client that is a Bank or Similar Institution

A firm, or principal in the firm, or any of that individual's immediate family, shall not accept a loan, or a guarantee of a loan, from a client that is a bank or a similar institution unless the loan or guarantee is made under normal lending procedures, terms and conditions.

Loans and Guarantees with a client that is not a Bank or Similar Institution

A firm, or principal in the firm, or any of that individual's immediate family, shall not make or guarantee a loan to a client unless:

- (a) the loan or guarantee is immaterial to the firm, or the individual making the loan or guarantee, as applicable, and the client; and
- (b) appropriate safeguards have been applied to reduce the threat to objectivity to an acceptable level.

A firm, or principal in the firm, or any of that individual's immediate family, shall not accept a loan from, or have a borrowing guaranteed by, a client that is not a bank or similar institution, unless:

- (a) the loan or guarantee is immaterial to the firm, or the individual receiving the loan or guarantee, as applicable, and the client; and
- (b) appropriate safeguards have been applied to reduce the threat to objectivity to an acceptable level.

(c) Beneficial Interest in Shares and other Investments

A self-interest threat to objectivity of a professional accountant might arise in relation to any investment in a company or undertaking with which there is a professional relationship. The threats shall be evaluated and safeguards shall be considered and applied as necessary. If the value of the investment is material to the financial circumstances of the professional accountant, the threat to independence cannot be reduced to an acceptable level by the application of any safeguards. Consequently, the professional accountant shall cease to advise professionally or dispose of the interest."

The Code provides the definition of “immediate family” in the Glossary as “A spouse (or equivalent) or dependent”.

## 4. Evaluating and addressing threats to objectivity

The existence of threats to objectivity when providing a professional service, and the addressing of those threats, will depend upon the particular facts and circumstances of the engagement and the nature of the work that the professional accountant is performing.

There are clear threats to compliance with the fundamental principle of objectivity resulting from a firm or individual having interests in, or relationships with, a client or its directors, officers or employees. There will only be very limited circumstances when those threats can be addressed. The threats need to be carefully considered prior to any such interests or relationships being initiated. It is up to the professional accountant to determine whether the threats created by such relationships can be reduced to an acceptable level given the particular circumstances of their engagement, and, in all cases, it will be for the professional accountant to explain and justify their actions. Documentation is encouraged throughout the decision-making process so that there is a record of the matters taken into consideration in reaching the judgement and action.

The following paragraphs discuss some factors that a professional accountant might need to consider when making an assessment as to whether adherence to the fundamental ethics principle of objectivity can be met, and case studies are provided in the Appendix offering examples of how these factors might be considered in practice:

### **Nature of the services being provided**

As it states at paragraph R370.5, objectivity is subject to a self-interest threat:

- when a firm, or principal of the firm, or any of that individual’s immediate family:
  - directly or indirectly makes a loan to, or receives a loan from, the client;
  - guarantees a loan to, or has a borrowing guaranteed by, a client.
- in relation to any investment (beneficial interest in shares and other investments) in a company or undertaking with which there is a professional relationship.

The self-interest threat to objectivity created by a firm or individual professional accountant having a loan with, or investment in, a client is ordinarily high. Care would also need to be taken if there are such transactions with a party related to the client, and professional accountants should also remain alert to the potential threats arising from immediate family members having relationships with clients.

With the exception of a loan from a client that is a bank or similar institution made under normal lending procedures, terms and conditions (see paragraph R370.5 of the Code noted above), for the majority of loans, and particularly when the professional accountant is in receipt of a loan from a client, the threats arising are likely to be too great to be able to be reduced to an acceptable level and the loan should not be initiated.

However, the particular nature of the services being provided to clients by the individual CA, or by a firm, might be a factor to consider as to whether the risk of breaching the fundamental principle of objectivity can be reduced to an acceptable level. In certain situations, the nature of the services a firm provides might enable objectivity to be safeguarded.

For example, firms can take many forms – consultancy, corporate finance boutique, compliance only, or multi-disciplinary. If a firm is purely a corporate finance boutique, the perceived risks of loans or investments with clients might be less, of course this depends on the specific facts and circumstances and the nature of the professional activities being

performed. Conversely, if a firm is a multi-disciplinary practice, the risk that a loan or investment with a client breaches the fundamental principle of objectivity is much higher. Ordinarily, the receipt of a loan from a client creates a greater risk to a professional accountant's objectivity than giving a loan to a client. There are likely to be very limited circumstances that a CA or a firm can accept a loan from a client. If a CA or firm does accept a loan from a client, they must be able to justify how they concluded that the fundamental ethics principle of objectivity had not been breached as a result of their actions - documentation is encouraged.

Whether or not the risk to objectivity of having a loan or investment with a client can be reduced to an acceptable level will therefore be very much dependent upon the specific facts and circumstances of the particular engagement.

### **Reasonable and informed third party test**

The Code requires professional accountants to have an inquiring mind; to exercise professional judgement; and to apply the 'reasonable and informed third party test'. The 'reasonable and informed third party test' is defined in the Code at paragraph 120.5 A6 as follows:

"The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time the conclusions are made. The reasonable and informed third party does not need to be an accountant, but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner."

The 'reasonable and informed third party' does not have to be an accountant, but does have to be an objective, knowledgeable, experienced and informed third party – i.e. not an uninformed member of the public – who can impartially consider the appropriateness of the accountant's conclusions.

The reasonable and informed third party test is very important. What is the likely 'third party' perception of your firm having a financial, or personal, interest in a client? It is particularly important where a firm is expressing an opinion where a third party could reasonably assume that the firm is independent.

Paragraph R370.4 states that "a professional accountant in public practice who provides an assurance service must be independent of their assurance client. Independence of mind and in appearance is necessary to enable the professional accountant to express a conclusion, and be seen to express a conclusion, without bias, conflict of interest, or undue influence of others." Part 4A (Independence for Audit and Review Engagements) and Part 4B (Independence for Assurance Engagements Other than Audit and Review Engagements) of the Code provide specific requirements and application material on independence when performing assurance engagements.

However, in relation to a situation where services other than assurance services are provided to a client, paragraph R370.5 (a) does not specifically prohibit professional accountants from being a director in a client company. Nevertheless, paragraph R370.5 (a) does highlight the serious threats to objectivity which result from such a relationship, and therefore the need for robust safeguards to be employed if objectivity is to be preserved in such circumstances (see further discussion below on safeguards). Similarly, paragraph 370.5 (c) does not specifically prohibit a professional accountant from investing in a client, provided appropriate safeguards are in place, but also provided the value of the investment is not material to the financial circumstances of the professional accountant, in which case no safeguards can reduce the threats to objectivity to an acceptable level. Investments in clients should also be monitored for "creeping materiality".

Objectivity must therefore be carefully considered before accepting directorships, or shareholdings in, client companies, with particular regard to 'the reasonable and informed third party' test. It is key that when considering whether to take on a directorship and/or shareholding of a client company, it is not whether you believe that you can be objective when providing services to that client, but whether a reasonable and informed third party would conclude that you are objective. If a reasonable and informed third party would conclude that you would not be objective then the appointment, engagement, or financial interest, should not be initiated.

This therefore restricts the types of services that can be provided i.e. no services can be provided where a third party could be given the impression that the accountancy firm involved is objective, or independent, in the particular circumstances. This would be a judgement call depending on the particular services being provided. Consideration needs to be given as to what outputs are being provided, if any, and are they being provided to external stakeholders such as other shareholders, bankers etc.

For example, you may be able to be a director/shareholder of your client and perform accounts preparation work for your client, provided necessary safeguards are put in place. However, you cannot sign a report on the client's financial statements if you are a director/shareholder of that client company, including a Chartered Accountant's Report for an accounts preparation engagement. A Chartered Accountant's Report is not technically necessary, therefore, as such, when a CA does sign a "Chartered Accountant's Report" for a set of financial statements it lends a degree of credibility to those financial statements. When a CA signs a "Chartered Accountant's Report", third parties should be able to expect that the CA who signs that "Chartered Accountant's Report" is independent from their client and that the work the CA performs is an objective assessment of the financial affairs of the company. If the CA is also a director and/or shareholder of the client this "objective" assessment is called into question, and with that also the integrity of the financial statements.

This is discussed further in ICAS' Framework for the Preparation of Accounts which provides guidance to CAs when undertaking an accounts preparation engagement.

### **Materiality**

A high risk to compliance with the fundamental principle of objectivity is created by any financial interest - loans, guarantees or investments - with a client. There is therefore a need to give due consideration to all financial interests, even if the value of an individual transaction in and of itself might be considered inconsequential. Due consideration would include having regard to the underlying substance and commerciality of the transaction and not merely its legal form.

As required by paragraph R370.5 of the Code as noted above, attention needs to be given to the 'materiality' of the financial interest to all parties. For example, there might be a circumstance where a multi-disciplinary firm could do compliance work for a client, when it also has an investment in the client, if the financial interest is immaterial to both parties. Loans with clients, as well as investments in clients, also need to be monitored for 'creeping materiality' in order to ensure objectivity can continue to be assured. A number of individually immaterial loans could be material in total. Similarly, investments can be immaterial to begin with, but subsequently become material. For example, when a client is just starting up in business the value of an investment could start as an immaterial amount, but then, as time passes, and if the client is successful, the value of the investment can subsequently become material.

### **Duration and frequency of financial interest**

The duration and frequency of a financial interest are also factors that need to be taken into account. If a financial interest has been going on for a long period of time, or if there are a series of individual loans, or investments, consideration needs to be given to the aggregate effect. Close attention needs to be paid to the development of the relationship with the client, as well as the changes in materiality in relation to the financial interest.

## **Capacity in which the professional accountant is acting**

All parties need to be clear as to the capacity in which the professional accountant is acting. Does your client see you as an adviser, or having a compliance role? Also, as noted earlier, what outputs are being provided? For example, are any reports being provided to external stakeholders such as other shareholders, bankers etc. The knowledge of the stakeholders as to the facts and circumstances also needs to be considered.

## **Family, or other personal or business, arrangements**

There is a need for particular care with family, or other personal or business, engagements. Objectivity may be subject to a self-interest threat where a mutual business interest, or personal relationship, exists with a client or any officer or employee of the client. There is a high inherent threat to objectivity when interacting professionally with family members or others with whom the accountant has a personal relationship. This can be very challenging to address, even under “normal” circumstances. Family, or personal, loyalties can pose a particularly significant threat to objectivity if the professional accountant discovers that business is not being conducted appropriately by the family member or friend. The professional accountant is bound to their professional responsibilities; however, this could conflict with personal allegiances.

Professional accountants who hold office in a client company, or have a comparable business relationship with a client, need to be aware of the dangers inherent in seeking to combine such a role with that of business adviser or the provision of another professional service. Also, as noted earlier, professional accountants need to remain alert to the potential threats to objectivity arising from immediate family members having relationships with clients. As per paragraph R370.5 (b), objectivity is subject to a self-interest threat when a firm, or principal of the firm, or any of that individual’s immediate family, directly or indirectly makes a loan to, or receives a loan from, the client, or guarantees a loan to, or has a borrowing guaranteed by, a client.

## **Safeguards**

When threats are identified as not being at an acceptable level - ‘acceptable level’ being defined in the Code (paragraph 120.7 A1) as “a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles” - the conceptual framework requires the professional accountant to address those threats by eliminating them or reducing them to an acceptable level. Paragraph 120.10 states the accountant shall do so by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (c) Declining or ending the specific professional activity.

Safeguards are specifically defined in the Code at paragraph 120.10 A2 as follows:

“Safeguards are actions, individually or in combination, that the professional accountant takes that effectively reduce threats to compliance with the fundamental principles to an acceptable level.”

Safeguards are therefore defined as specific actions which directly target and address the threat in question. A safeguard may include an appropriate independent party reviewing the work of the professional accountant. Transparency may also be a possible safeguard – the disclosure of the financial interest, and/or the relationship, to any relevant parties.

## 5. Conclusion

The ICAS Code of Ethics includes a conceptual framework to help professional accountants to assess the level of any threat to complying with the fundamental ethics principles and then address any threats by eliminating them or reducing them to an acceptable level by applying safeguards.

A professional accountant's objectivity can be threatened by financial interests in and/or relationships (business, family or other personal) with their client.

The existence of threats to objectivity, and the ability of the professional accountant to eliminate, or reduce the threats to an acceptable level, will depend upon the particular circumstances of the engagement and the nature of the work that the professional accountant is performing.

Ultimately, professional accountants will need to exercise professional judgement depending upon the facts and circumstances of each individual engagement, always considering the views of a reasonable and informed third party, and it will be for the professional accountant to explain and justify their actions. Documentation is encouraged throughout the decision-making process.

## Appendix - Case Studies

The following scenarios are provided to illustrate how the conceptual framework in the ICAS Code of Ethics might be applied in relation to threats to the fundamental principle of objectivity when there are financial interests in, or relationships with, clients. In each example, an 'analysis of the scenario' is provided by discussing in turn identifying, evaluating and addressing the threat to objectivity in accordance with the conceptual framework.

**Case Study 1:** Boutique corporate finance adviser - Loan to client company

**Case Study 2:** General practitioner - Loan to assist with payment of client PAYE liabilities

**Case Study 3:** General practitioner - Loan to client company experiencing cash flow issues and owned by a family member

**Case Study 4:** General practitioner - Loan from a client

**Case Study 5:** General practitioner - Directorship/shareholding in client company

**Case Study 6:** General practitioner - Independent examiner asked to assist a charity client with a project

**Case Study 7:** General practitioner - Independent examiner's spouse asked to be trustee of charity client

# Case study 1: Boutique corporate finance adviser - Loan to client company

ABC is a boutique corporate finance advisory firm. It is not engaged in providing any services associated with more traditional general practice, such as accountancy, audit or tax compliance services, to any of its clients.

ABC has an equity investment in a client company and one of the partners of ABC is also a director of the client company.

ABC is now looking to provide loan finance to the client company. The loan would be made on a commercial basis. ABC considers the loan to be another form of investment attracting a different return and risk profile to the equity investment.

The other shareholders and investors of the client company are aware of all the inter-relationships between ABC, its partners, and the client company.

## ICAS Code of Ethics - Application of Conceptual Framework

At Section 120, the Code provides a conceptual framework that professional accountants shall apply to ensure adherence to the fundamental principles. The conceptual framework requires professional accountants to:

- (a) identify threats to compliance with the fundamental principles;
- (b) evaluate the threats identified; and
- (c) address the threats by eliminating them, or reducing them to an acceptable level by applying safeguards.

The Code also requires professional accountants to have an inquiring mind; to exercise professional judgement; and to apply the 'reasonable and informed third party test'.

An 'Analysis of the scenario' in relation to the identification, evaluation and addressing of the threats to objectivity in this situation is provided in turn below.

Documentation is encouraged throughout the decision-making process so that there is a record of the matters taken into consideration in reaching the judgement and action.

### (a) Identifying the threats to objectivity

The Code states that threats to compliance with the fundamental principles fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgement or behaviour;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgement made, or an activity performed by the accountant or by another individual within the accountant's firm or employing organisation, on which the accountant will rely when forming a judgement as part of performing a current activity;
- (c) Advocacy threat – the threat that a professional accountant will promote a client's or employing organisation's position to the point that the accountant's objectivity is compromised;
- (d) Familiarity threat – the threat that due to a long or close relationship with a client, or employing organisation, a professional accountant will be too sympathetic to their interests or too accepting of their work; and

- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

### ***Analysis of the scenario***

The following potential threats to the fundamental principle of objectivity might exist as a result of ABC's financial and other relationships with its client:

- Equity investment: potential self-interest threat, potential advocacy threat depending on facts and circumstances.
- Debt investment: potential self-interest threat, potential advocacy threat depending on facts and circumstances.
- One of the partners of ABC is a director of the client company: Potential familiarity threat.

ABC must also ensure adherence to the specific requirements contained within Section 370 of the ICAS Code of Ethics which includes the following:

#### **“Family, other personal or business relationships**

Objectivity might be subject to a self-interest threat where a mutual business interest exists with a client or any officer or employee of the client. In such circumstances safeguards shall be applied and adequate disclosure of any conflict of interest shall be made to all relevant parties.

Professional accountants who hold office in a client company or have a comparable business relationship with a client, shall be aware of the dangers inherent in seeking to combine such a role with that of business adviser or other professional service having regard to the self-interest threat to their objectivity. In such circumstances, professional accountants shall be aware of the distinctive nature of each of the roles in which they are professionally engaged, and employ safeguards, including disclosure where appropriate.

#### **Loans and Guarantees with a client that is not a Bank or Similar Institution**

A firm, or principal in the firm, or any of that individual's immediate family, shall not make or guarantee a loan to a client unless:

- (a) the loan or guarantee is immaterial to the firm, or the individual making the loan or guarantee, as applicable, and the client; and
- (b) appropriate safeguards have been applied to reduce the threat to objectivity to an acceptable level.

#### **Beneficial Interest in Shares and other Investments**

A self-interest threat to objectivity of a professional accountant might arise in relation to any investment in a company or undertaking with which there is a professional relationship. The threats shall be evaluated and safeguards shall be considered and applied as necessary. If the value of the investment is material to the financial circumstances of the professional accountant, the threat to independence cannot be reduced to an acceptable level by the application of any safeguards. Consequently, the professional accountant shall cease to advise professionally or dispose of the interest.”

### **(b) Evaluating the threats to objectivity**

#### ***Matters to consider***

- What are the nature of the services being provided to the client?
- The self-interest threat to objectivity created by a firm, or an individual professional accountant, having a loan with, or investment in, a client is ordinarily high.
- With a purely corporate finance boutique the perceived threats to objectivity of loans might be less than that of a multi-disciplinary practice.

- Whether the risk to objectivity can be reduced to an acceptable level will be dependent upon the specific facts and circumstances, including the nature of the particular engagement.
- Reasonable and informed third party test
  - The reasonable and informed third party test is very important: what is the likely ‘third party’ perception of the firm having a financial, or personal, interest in the client? It is not whether the firm believes that they can be objective but whether a reasonable and informed third party would conclude that they are objective.
  - This test is particularly key when a firm is expressing an opinion and a third party could reasonably assume that the firm is independent.
  - If a reasonable and informed third party would conclude that you would not be objective then the appointment, engagement, or financial interest, should not be initiated.
- How material are the transactions?
  - Due consideration needs to be given to all financial interests, even if the value of an individual transaction in and of itself might be considered inconsequential.
  - Due consideration includes having regard to the underlying substance and commerciality of the transaction and not merely its legal form.
  - Attention needs to be given to the ‘materiality’ of the financial interest to all parties.
  - Loans with clients, as well as investments in clients, need to be monitored for ‘creeping materiality’. A number of individually immaterial loans could be material in total. Investments can be immaterial to begin with, but subsequently become material.
- Duration and frequency of a financial interest
  - If a financial interest has been going on for a long period of time, or if there are a series of individual loans, or investments, consideration needs to be given to the aggregate effect.
  - Close attention also needs to be paid to the development of the relationship with the client.
- Capacity in which the professional accountant is acting
  - All parties need to be clear as to the capacity in which the professional accountant is acting - does your client see you as an adviser, or having a compliance role?
  - The knowledge of the stakeholders as to the facts and circumstances needs to be considered.
  - Consideration needs to be given to what outputs (e.g. reports) are being provided, if any, and are they being provided to external stakeholders such as other shareholders, bankers etc.?
- Family, or other personal or business, arrangements
  - Family, or personal, loyalties can pose a particularly significant threat to objectivity.
  - Professional responsibilities could conflict with personal allegiances.
  - When holding office in a client company, or having a comparable business relationship with a client, there is a need to be aware of conflicts of interest and the dangers inherent in seeking to combine such a role with that of business adviser or the provision of another professional service.

### ***Analysis of the scenario***

ABC is a boutique corporate finance adviser. With a purely corporate finance boutique the perceived threats to objectivity of loans or investments might be less than that of a multi-disciplinary practice. Whether the risk to objectivity can be reduced to an acceptable level will be dependent upon the specific facts and circumstances.

The level of threat may be reduced by the firm not providing any accounting, audit or tax services that may possibly be relied on by third parties.

The loan finance is being made by ABC to the client company on an arm’s length basis; however, the materiality of the transaction to both the firm and the client still needs to be considered.

Consideration also needs to be given as to whether there is any risk that external parties could place reliance on what they believe to be 'independent' information from ABC for decision making purposes. The partner of ABC who is also a director of the client company could be in a position of being able to exert influence. There is also a need to consider if there are any potential conflicts of interest resulting from the partner of ABC also being a director of the client company.

Threats might be at their most prevalent if the business were to be put up for sale or other investors were being brought on board. The level of the threat would appear to relate more to the equity investment. This might be reduced by the fact that the firm does not prepare the accounts, but there would need to be consideration of all the facts and circumstances.

### **(c) Addressing the threats to objectivity**

When threats are identified as not being at an acceptable level, the Code requires the professional accountant to address those threats by eliminating them or reducing them to an acceptable level.

Threats are addressed by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (c) Declining or ending the specific professional activity.

Safeguards are defined in the Code as specific actions which directly target and address the threat in question. For example:

- A safeguard may include an appropriate independent party reviewing the work of the professional accountant.
- Transparency may be a possible safeguard – the disclosure of the financial interest, or close relationship, to any relevant parties.

### ***Analysis of the scenario***

Transparency may be a possible safeguard to threats to objectivity. As the other shareholders and investors are aware of all the inter-relationships between ABC and the client company this might be a safeguard.

Consideration should also be given as to whether the client company's bank is aware of the common shareholdings and proposed loan.

Also, is the client company audited annually by an independent firm?

No services can be provided where a third party could be given the impression that ABC or its partners are objective, or independent, in the particular circumstances; however, the partners of ABC could prepare the accounts for the client company provided they do not try to make it look like an independent accountancy firm has prepared them.

None of the partners in a firm can sign a report on a client's financial statements if one of the partners in the firm is a director/shareholder of that client company, including a Chartered Accountant's Report for an accounts preparation engagement. A Chartered Accountant's Report is not technically necessary, therefore, as such, when a CA does sign a "Chartered Accountant's Report" for a set of financial statements it lends a degree of credibility to those financial statements. When a CA signs a "Chartered Accountant's Report", third parties should be able to expect that the CA who signs that "Chartered Accountant's Report" is independent from their client and that the work the CA performs is an objective assessment of the financial affairs of the company. If the CA is also a director and/or shareholder of the client this 'objective' assessment is called into question, and with that also the integrity of the financial statements.

## Case Study 2: General practitioner - Loan to assist with payment of client PAYE liabilities

You are a partner in a small CA practice. A client company asks you to help pay its £100 PAYE liability for a number of months to help with cash flows. As a result of these cash flow difficulties, the client also cannot pay their outstanding fees due to you.

### ICAS Code of Ethics - Application of Conceptual Framework

At Section 120, the Code provides a conceptual framework that professional accountants shall apply to ensure adherence to the fundamental principles. The conceptual framework requires professional accountants to:

- (a) identify threats to compliance with the fundamental principles;
- (b) evaluate the threats identified; and
- (c) address the threats by eliminating them, or reducing them to an acceptable level by applying safeguards.

The Code also requires professional accountants to have an inquiring mind; to exercise professional judgement; and to apply the 'reasonable and informed third party test'.

An 'Analysis of the scenario' in relation to the identification, evaluation and addressing of the threats to objectivity in this situation is provided in turn below.

Documentation is encouraged throughout the decision-making process so that there is a record of the matters taken into consideration in reaching the judgement and action.

#### (a) Identifying the threats to objectivity

The Code states that threats to compliance with the fundamental principles fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgement or behaviour;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgement made, or an activity performed by the accountant or by another individual within the accountant's firm or employing organisation, on which the accountant will rely when forming a judgement as part of performing a current activity;
- (c) Advocacy threat – the threat that a professional accountant will promote a client's or employing organisation's position to the point that the accountant's objectivity is compromised;
- (d) Familiarity threat – the threat that due to a long or close relationship with a client, or employing organisation, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

#### *Analysis of the scenario*

The following potential threats to the fundamental principle of objectivity might exist as a result of you providing funds to a client to help with cash flows:

- Potential self-interest threat (both from the outstanding fees and any amounts provided to cover the PAYE liability), potential advocacy threat depending on the facts and circumstances.

- Possibility of an intimidation threat (if non-payment at a later date).
- Potential familiarity threat.

You must also ensure adherence to the specific requirement contained within Section 370 of the ICAS Code of Ethics which states:

**“Loans and Guarantees with a client that is not a Bank or Similar Institution**

A firm, or principal in the firm, or any of that individual's immediate family, shall not make or guarantee a loan to a client unless:

- (a) the loan or guarantee is immaterial to the firm, or the individual making the loan or guarantee, as applicable, and the client; and
- (b) appropriate safeguards have been applied to reduce the threat to objectivity to an acceptable level.”

## **(b) Evaluating the threats to objectivity**

### ***Matters to consider***

- What are the nature of the services being provided to the client?
  - The self-interest threat to objectivity created by a firm, or an individual professional accountant, having a loan with a client is ordinarily high.
  - Whether the risk to objectivity can be reduced to an acceptable level will be dependent upon the specific facts and circumstances, including the nature of the particular engagement.
- Reasonable and informed third party test
  - The reasonable and informed third party test is very important - what is the likely “third party” perception of a firm having a financial, or personal, interest in a client?
  - It is not whether you believe that you can be objective but whether a reasonable and informed third party would conclude that you are objective.
  - This test is particularly key when a firm is expressing an opinion and a third party could reasonably assume that the firm is independent.
  - If a reasonable and informed third party would conclude that you would not be objective then the appointment, engagement, or financial interest, should not be initiated.
- How material are the transactions?
  - Due consideration needs to be given to all financial interests, even if the value of the transaction in and of itself might be considered inconsequential.
  - Due consideration includes having regard to the underlying substance and commerciality of the transaction.
  - Attention needs to be given to the “materiality” of the financial interest to all parties.
  - Loans with clients need to be monitored for ‘creeping materiality’. A number of individually immaterial loans could be material in total.
- Duration and frequency of a financial interest
  - If a financial interest has been going on for a long period of time, or if there are a series of individual loans, consideration needs to be given to the aggregate effect.
  - Close attention also needs to be paid to the development of the relationship with the client.
- Capacity in which the professional accountant is acting
  - All parties need to be clear as to the capacity in which the professional accountant is acting - does your client see you as an adviser, or having a compliance role?
  - The knowledge of the stakeholders as to the facts and circumstances needs to be considered.
  - Consideration needs to be given to what outputs (e.g. reports) are being provided, if any, and are they being provided to external stakeholders such as other shareholders, bankers etc.?
- Family, or other personal or business, arrangements
  - Family, or personal, loyalties can pose a particularly significant threat to objectivity.
  - Professional responsibilities could conflict with personal allegiances.

### ***Analysis of the scenario***

The funds provided by your firm to cover your client's PAYE outlays would be a loan to your client. This is in addition to the exposure that your firm has as the client also cannot pay their outstanding fees.

Your firm is a multi-disciplinary practice providing services that may possibly be relied on by third parties.

Consideration needs to be given as to whether there is any risk that external parties could place reliance on what they believe to be 'independent' information from your firm for decision making purposes.

Materiality to both parties needs to be considered. For example, the provision of the funding might not be material to you, but it could be material to your client if they are having cash flow difficulties, and they are struggling to obtain funding from elsewhere. The alternative view might be that the values might be so immaterial as to make any risk of a self-interest threat etc negligible.

If the arrangement goes on for a long period of time, with a series of individual "loans", consideration needs to be given to the aggregate effect - "creeping materiality". Particular care needs to be taken given that any amounts to cover PAYE outlays are in addition to any fees which the client has not paid to you.

The reasonable and informed third party test needs to be considered - what is the likely "third party" perception of your firm having this financial interest in your client?

### **(c) Addressing the threats to objectivity**

When threats are identified as not being at an acceptable level, the Code requires the professional accountant to address those threats by eliminating them or reducing them to an acceptable level.

Threats are addressed by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (c) Declining or ending the specific professional activity.

Safeguards are defined in the Code as specific actions which directly target and address the threat in question. For example:

- A safeguard may include an appropriate independent party reviewing the work of the professional accountant.
- Transparency may be a possible safeguard – the disclosure of the financial interest, or close relationship, to any relevant parties.

### ***Analysis of the scenario***

If it is concluded that the loan would be material to either party, there are no safeguards which can reduce the threat to an acceptable level, and your firm should not provide the funds to your client.

If it is considered that the provision of the funds is immaterial to both your firm and your client, consideration needs to be given as to whether there are any safeguards which might reduce the threat to objectivity to an acceptable level such as whether an appropriate independent party reviewing your firm's work in relation to the client might be a safeguard.

## Case Study 3: General practitioner – Loan to client company experiencing cash flow issues and owned by a family member

You are a partner in a CA firm. One of your clients is your brother-in-law who started his own business a few years ago. He called you one day explaining that his company is having some cash flow issues as the largest customer was, unusually, taking longer to pay their invoices. The bank has refused to extend the company's overdraft and the staff need to be paid at the end of the week. The customer has promised they will pay him in the next 60 days. Could you lend his company £5,000 until the customer pays?

### ICAS Code of Ethics - Application of Conceptual Framework

At Section 120, the Code provides a conceptual framework that professional accountants shall apply to ensure adherence to the fundamental principles. The conceptual framework requires professional accountants to:

- (a) identify threats to compliance with the fundamental principles;
- (b) evaluate the threats identified; and
- (c) address the threats by eliminating them, or reducing them to an acceptable level by applying safeguards.

The Code also requires professional accountants to have an inquiring mind; to exercise professional judgement; and to apply the 'reasonable and informed third party test'.

An 'Analysis of the scenario' in relation to the identification, evaluation and addressing of the threats to objectivity in this situation is provided in turn below.

Documentation is encouraged throughout the decision-making process so that there is a record of the matters taken into consideration in reaching the judgement and action.

#### (a) Identifying the threats to objectivity

The Code states that threats to compliance with the fundamental principles fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgement or behaviour;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgement made, or an activity performed by the accountant or by another individual within the accountant's firm or employing organisation, on which the accountant will rely when forming a judgement as part of performing a current activity;
- (c) Advocacy threat – the threat that a professional accountant will promote a client's or employing organisation's position to the point that the accountant's objectivity is compromised;
- (d) Familiarity threat – the threat that due to a long or close relationship with a client, or employing organisation, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

## ***Analysis of the scenario***

The following potential threats to the fundamental principle of objectivity might exist as a result of you providing funds to your brother-in-law's company to help with cash flows:

- Potential self-interest threat, potential advocacy threat depending on the facts and circumstances.
- Possibility of an intimidation threat (if non-payment at a later date).
- Potential familiarity threat.

You must also ensure adherence to the specific requirement contained within Section 370 of the ICAS Code of Ethics which states:

### **“Loans and Guarantees with a client that is not a Bank or Similar Institution**

A firm, or principal in the firm, or any of that individual's immediate family, shall not make or guarantee a loan to a client unless:

- (a) the loan or guarantee is immaterial to the firm, or the individual making the loan or guarantee, as applicable, and the client; and
- (b) appropriate safeguards have been applied to reduce the threat to objectivity to an acceptable level.”

## **(b) Evaluating the threats to objectivity**

### ***Matters to consider***

- What are the nature of the services being provided to the client?
  - The self-interest threat to objectivity created by a firm, or an individual professional accountant, having a loan with a client is ordinarily high.
  - Whether the risk to objectivity can be reduced to an acceptable level will be dependent upon the specific facts and circumstances, including the nature of the particular engagement.
- Reasonable and informed third party test
  - The reasonable and informed third party test is very important - what is the likely “third party” perception of the firm having a financial, or personal, interest in a client?
  - It is not whether you believe that you can be objective but whether a reasonable and informed third party would conclude that you are objective.
  - This test is particularly key when a firm is expressing an opinion and a third party could reasonably assume that the firm is independent.
  - If a reasonable and informed third party would conclude that you would not be objective then the appointment, engagement, or financial interest, should not be initiated.
- How material are the transactions?
  - Due consideration needs to be given to all financial interests, even if the value of the transaction in and of itself might be considered inconsequential.
  - Due consideration includes having regard to the underlying substance and commerciality of the transaction.
  - Attention needs to be given to the “materiality” of the financial interest to all parties.
  - Loans with clients need to be monitored for ‘creeping materiality’. A number of individually immaterial loans could be material in total.
- Duration and frequency of a financial interest
  - If a financial interest has been going on for a long period of time, or if there are a series of individual loans, consideration needs to be given to the aggregate effect.
  - Close attention also needs to be paid to the development of the relationship with the client.
- Capacity in which the professional accountant is acting

- All parties need to be clear as to the capacity in which the professional accountant is acting - does your client see you as an adviser, or having a compliance role?
- The knowledge of the stakeholders as to the facts and circumstances needs to be considered.
- Consideration needs to be given to what outputs (e.g. reports) are being provided, if any, and are they being provided to external stakeholders such as other shareholders, bankers etc.?
- Family, or other personal or business, arrangements
- Family, or personal, loyalties can pose a particularly significant threat to objectivity.
- Professional responsibilities could conflict with personal allegiances.

### ***Analysis of the scenario***

Your firm is a multi-disciplinary practice providing services that may possibly be relied on by third parties.

Consideration needs to be given as to whether there is any risk that external parties could place reliance on what they believe to be 'independent' information from your firm for decision making purposes.

Materiality to both parties needs to be considered. For example, the provision of the £5,000 might not be material to your firm; however, given your brother-in-law's company is having cash flow difficulties, it might be material to it.

You also have the complication of the family connection which may threaten your objectivity. The reasonable and informed third party test needs to be considered - what is the likely "third party" perception of your firm having this financial interest in your brother-in-law's business?

### **(c) Addressing the threats to objectivity**

When threats are identified as not being at an acceptable level, the Code requires the professional accountant to address those threats by eliminating them or reducing them to an acceptable level.

Threats are addressed by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (c) Declining or ending the specific professional activity.

Safeguards are defined in the Code as specific actions which directly target and address the threat in question. For example:

- A safeguard may include an appropriate independent party reviewing the work of the professional accountant.
- Transparency may be a possible safeguard – the disclosure of the financial interest, or close relationship, to any relevant parties.

### ***Analysis of the scenario***

There is a high risk that it could be concluded that the loan would be material to your brother-in-law's company and therefore making this loan would be considered a breach of the provisions in Section 370 of the ICAS Code of Ethics. There appear to be no safeguards, and the loan should therefore not be advanced.

## Case Study 4: General practitioner – Loan from a client

You are a CA and partner in a CA firm.

Your firm has been experiencing some cashflow issues. You have confided in a long-standing client of your firm. They have offered to lend you up to £75,000 to help you through this difficult time. There wouldn't need to be a formal agreement, you could just draw down what you need and pay them back with interest, netting your fees against the outstanding balance.

### ICAS Code of Ethics - Application of Conceptual Framework

At Section 120, the Code provides a conceptual framework that professional accountants shall apply to ensure adherence to the fundamental principles. The conceptual framework requires professional accountants to:

- (a) identify threats to compliance with the fundamental principles;
- (b) evaluate the threats identified; and
- (c) address the threats by eliminating them, or reducing them to an acceptable level by applying safeguards.

The Code also requires professional accountants to have an inquiring mind; to exercise professional judgement; and to apply the 'reasonable and informed third party test'.

An 'Analysis of the scenario' in relation to the identification, evaluation and addressing of the threats to objectivity in this situation is provided in turn below.

Documentation is encouraged throughout the decision-making process so that there is a record of the matters taken into consideration in reaching the judgement and action.

#### **(a) Identifying the threats to objectivity**

The Code states that threats to compliance with the fundamental principles fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgement or behaviour;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgement made, or an activity performed by the accountant or by another individual within the accountant's firm or employing organisation, on which the accountant will rely when forming a judgement as part of performing a current activity;
- (c) Advocacy threat – the threat that a professional accountant will promote a client's or employing organisation's position to the point that the accountant's objectivity is compromised;
- (d) Familiarity threat – the threat that due to a long or close relationship with a client, or employing organisation, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

#### ***Analysis of the scenario***

The following potential threats to the fundamental principle of objectivity might exist as a result of your firm receiving a loan from your client to help with cash flows:

- Potential self-interest threat, potential advocacy threat depending on the facts and circumstances.
- Possibility of an intimidation threat (if non-payment at a later date).
- Potential familiarity threat.

Your firm must also ensure adherence to the specific requirement contained within Section 370 of the ICAS Code of Ethics which states:

**“Loans and Guarantees with a client that is not a Bank or Similar Institution**

A firm, or principal in the firm, or any of that individual's immediate family, shall not accept a loan from, or have a borrowing guaranteed by, a client that is not a bank or similar institution, unless:

- (a) the loan or guarantee is immaterial to the firm, or the individual receiving the loan or guarantee, as applicable, and the client; and
- (b) appropriate safeguards have been applied to reduce the threat to objectivity to an acceptable level.”

## **(b) Evaluating the threats to objectivity**

### ***Matters to consider***

- What are the nature of the services being provided to the client?
  - The self-interest threat to objectivity created by a firm, or an individual professional accountant, having a loan from a client is ordinarily high.
  - Whether the risk to objectivity can be reduced to an acceptable level will be dependent upon the specific facts and circumstances, including the nature of the particular engagement.
- Reasonable and informed third party test
  - The reasonable and informed third party test is very important - what is the likely “third party” perception of the firm having a loan from a client?
  - It is not whether you believe that you can be objective but whether a reasonable and informed third party would conclude that you are objective.
  - This test is particularly key when a firm is expressing an opinion and a third party could reasonably assume that the firm is independent.
  - If a reasonable and informed third party would conclude that you would not be objective then the appointment, engagement, or financial interest, should not be initiated.
- How material are the transactions?
  - Due consideration needs to be given to all financial interests, even if the value of the transaction in and of itself might be considered inconsequential.
  - Due consideration includes having regard to the underlying substance and commerciality of the transaction.
  - Attention needs to be given to the “materiality” of the financial interest to all parties.
  - Loans with clients need to be monitored for ‘creeping materiality’. A number of individually immaterial loans could be material in total.
- Duration and frequency of a financial interest
  - If a financial interest has been going on for a long period of time, or if there are a series of individual loans, consideration needs to be given to the aggregate effect.
  - Close attention also needs to be paid to the development of the relationship with the client.
- Capacity in which the professional accountant is acting
  - All parties need to be clear as to the capacity in which the professional accountant is acting - does your client see you as an adviser, or having a compliance role?
  - The knowledge of the stakeholders as to the facts and circumstances needs to be considered.
  - Consideration needs to be given to what outputs (e.g. reports) are being provided, if any, and are they being provided to external stakeholders such as other shareholders, bankers etc.?
- Family, or other personal or business, arrangements
  - Family, or personal, loyalties can pose a particularly significant threat to objectivity.
  - Professional responsibilities could conflict with personal allegiances.

### ***Analysis of the scenario***

Section 370 states that “A firm, or principal in the firm, or any of that individual’s immediate family, shall not accept a loan from, or have a borrowing guaranteed by, a client that is not a bank or similar institution, unless: (a) the loan or guarantee is immaterial to the firm, or the individual receiving the loan or guarantee, as applicable, and the client.”

Materiality to both parties needs to be considered. The loan might not be material to your client if their business is cash rich, however, given your firm is experiencing financial difficulties, it is likely the loan is material to you.

### **(c) Addressing the threats to objectivity**

When threats are identified as not being at an acceptable level, the Code requires the professional accountant to address those threats by eliminating them or reducing them to an acceptable level.

Threats are addressed by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (c) Declining or ending the specific professional activity.

Safeguards are defined in the Code as specific actions which directly target and address the threat in question. For example:

- A safeguard may include an appropriate independent party reviewing the work of the professional accountant.
- Transparency may be a possible safeguard – the disclosure of the financial interest, or close relationship, to any relevant parties.

### ***Analysis of the scenario***

You should be aware that there is a high risk that receiving this loan from your client would be considered a breach of the provisions in Section 370 of the ICAS Code of Ethics, there appear to be no safeguards, and the loan should therefore not be accepted.

## Case Study 5: General practitioner – Directorship/shareholding in client company

You are a CA and partner in a firm providing accounting, audit and tax services.

You have provided accounting services to one of your clients for several years, and they have now asked you to join the board of their company, including offering you a shareholding in their business.

### ICAS Code of Ethics - Application of Conceptual Framework

At Section 120, the Code provides a conceptual framework that professional accountants shall apply to ensure adherence to the fundamental principles. The conceptual framework requires professional accountants to:

- (a) identify threats to compliance with the fundamental principles;
- (b) evaluate the threats identified; and
- (c) address the threats by eliminating them, or reducing them to an acceptable level by applying safeguards.

The Code also requires professional accountants to have an inquiring mind; to exercise professional judgement; and to apply the 'reasonable and informed third party test'.

An 'Analysis of the scenario' in relation to the identification, evaluation and addressing of the threats to objectivity in this situation is provided in turn below.

Documentation is encouraged throughout the decision-making process so that there is a record of the matters taken into consideration in reaching the judgement and action.

#### **(a) Identifying the threats to objectivity**

The Code states that threats to compliance with the fundamental principles fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgement or behaviour;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgement made, or an activity performed by the accountant or by another individual within the accountant's firm or employing organisation, on which the accountant will rely when forming a judgement as part of performing a current activity;
- (c) Advocacy threat – the threat that a professional accountant will promote a client's or employing organisation's position to the point that the accountant's objectivity is compromised;
- (d) Familiarity threat – the threat that due to a long or close relationship with a client, or employing organisation, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

## ***Analysis of the scenario***

The following potential threats to the fundamental principle of objectivity might exist as a result of your involvement with your client:

- Potential self-interest threat.
- Potential self-review threat.
- Potential familiarity threat.
- Potential management threat (additional threat recognised in FRC's Ethical Standard).

You must also ensure adherence to the specific requirements contained within Section 370 of the ICAS Code of Ethics which states:

### **“Family, other personal or business relationships**

Objectivity might be subject to a self-interest threat where a mutual business interest exists with a client or any officer or employee of the client. In such circumstances safeguards shall be applied and adequate disclosure of any conflict of interest shall be made to all relevant parties.

Professional accountants who hold office in a client company or have a comparable business relationship with a client, shall be aware of the dangers inherent in seeking to combine such a role with that of business adviser or other professional service having regard to the self-interest threat to their objectivity. In such circumstances, professional accountants shall be aware of the distinctive nature of each of the roles in which they are professionally engaged, and employ safeguards, including disclosure where appropriate.

### **Beneficial Interest in Shares and other Investments**

A self-interest threat to objectivity of a professional accountant might arise in relation to any investment in a company or undertaking with which there is a professional relationship. The threats shall be evaluated and safeguards shall be considered and applied as necessary. If the value of the investment is material to the financial circumstances of the professional accountant, the threat to independence cannot be reduced to an acceptable level by the application of any safeguards. Consequently, the professional accountant shall cease to advise professionally or dispose of the interest.”

## **(b) Evaluating the threats to objectivity**

### ***Matters to consider***

- What are the nature of the services being provided to the client?
  - The self-interest threat to objectivity created by a firm, or an individual professional accountant, having an investment in a client, and/or becoming a director of a client, is ordinarily high.
  - Whether the risk to objectivity can be reduced to an acceptable level will be dependent upon the specific facts and circumstances, including the nature of the particular engagement.
- Reasonable and informed third party test
  - The reasonable and informed third party test is very important: what is the likely ‘third party’ perception of the firm having a financial, or personal, interest in the client?
  - When considering whether to take on a directorship/shareholding of a client company, it is not whether you believe that you can be objective but whether a reasonable and informed third party would conclude that you are objective.
  - This test is particularly key when a firm is expressing an opinion and a third party could reasonably assume that the firm is independent.
  - If a reasonable and informed third party would conclude that you would not be objective then the appointment, engagement, or financial interest, should not be initiated.

- How material are the transactions?
  - Due consideration needs to be given to all financial interests, even if the value of an individual transaction in and of itself might be considered inconsequential.
  - Due consideration includes having regard to the underlying substance and commerciality of the transaction and not merely its legal form.
  - Attention needs to be given to the 'materiality' of the financial interest to all parties.
  - Investments in clients need to be monitored for 'creeping materiality'. Investments can be immaterial to begin with, but subsequently become material.
- Duration and frequency of a financial interest
  - If a financial interest has been going on for a long period of time, or if there are a series of individual investments, consideration needs to be given to the aggregate effect.
  - Close attention also needs to be paid to the development of the relationship with the client.
- Capacity in which the professional accountant is acting
  - All parties need to be clear as to the capacity in which you are acting if you are also a director of the client company - does your client see you as an adviser, or having a compliance role?
  - The knowledge of the stakeholders as to the facts and circumstances needs to be considered.
  - Consideration needs to be given to what outputs (e.g. reports) are being provided, if any, and are they being provided to external stakeholders such as other shareholders, bankers etc.?
- Family, or other personal or business, arrangements
  - Family, or personal, loyalties can pose a particularly significant threat to objectivity.
  - Professional responsibilities could conflict with personal allegiances.
  - When holding office in a client company, or having a comparable business relationship with a client, there is a need to be aware of conflicts of interest and the dangers inherent in seeking to combine such a role with that of business adviser or the provision of another professional service.

### ***Analysis of the scenario***

Your firm is a multi-disciplinary practice providing accounting, audit and tax services.

A professional accountant in public practice who provides an assurance service must be independent of their assurance client. However, in relation to situations where services other than assurance services are provided to a client, Section 370 does not specifically prohibit professional accountants from being a director in a client company.

Section 370 also does not specifically prohibit a professional accountant from investing in a client, but this is provided appropriate safeguards are in place and that the value of the investment is not material to the financial circumstances of the professional accountant (if the value of the investment is material, no safeguards can reduce the threats to objectivity to an acceptable level). Investments in clients also need to be monitored for "creeping materiality" (i.e. investments can be immaterial to begin with, but subsequently become material).

It is key that, when considering whether to take on a directorship/shareholding, it is not whether you believe that you can be objective when providing services to your client, but whether a 'reasonable and informed third party' would conclude that you are objective.

This therefore restricts the types of services that can be provided i.e. no services can be provided where a third party could be given the impression that your firm is objective, or independent, in the particular circumstances.

Consideration needs to be given to what outputs are being provided, if any, and are they being provided to external stakeholders such as other shareholders, bankers etc.

### **(c) Addressing the threats to objectivity**

When threats are identified as not being at an acceptable level, the Code requires the professional accountant to address those threats by eliminating them or reducing them to an acceptable level.

Threats are addressed by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (c) Declining or ending the specific professional activity.

Safeguards are defined in the Code as specific actions which directly target and address the threat in question. For example:

- A safeguard may include an appropriate independent party reviewing the work of the professional accountant.
- Transparency may be a possible safeguard – the disclosure of the financial interest, or close relationship, to any relevant parties.

### ***Analysis of the scenario***

Provided you meet the requirements of Section 370, and the ‘reasonable and informed third party test’, you may be able to be a director/shareholder of your client, and, provided necessary safeguards are put in place, would be able to continue to perform accounts preparation work for your client.

Transparency might be a possible safeguard – i.e. the disclosure of the financial interest and directorship/shareholding to any relevant parties.

However, no services can be provided where a third party could be given the impression that you or your firm are objective, or independent, in the particular circumstances. You and the other partners in your firm cannot sign a report on the client’s financial statements if you are a director/shareholder of that client company, including a Chartered Accountant’s Report for an accounts preparation engagement. A Chartered Accountant’s Report is not technically necessary, therefore, as such, when a CA does sign a “Chartered Accountant’s Report” for a set of financial statements it lends a degree of credibility to those financial statements. When a CA signs a “Chartered Accountant’s Report”, third parties should be able to expect that the CA who signs that “Chartered Accountant’s Report” is independent from their client and that the work the CA performs is an objective assessment of the financial affairs of the company. If the CA is also a director and/or shareholder of the client this ‘objective’ assessment is called into question, and with that also the integrity of the financial statements.

## Case Study 6: General practitioner – Independent examiner asked to assist a charity client with a project

You are a partner in a small CA firm. One of your clients is a small charity. You perform the Independent Examination for this client.

One day, you receive a call from the Chair of the Board of Trustees. The Chair explains the call is nothing to do with this year's Independent Examination. The charity is undertaking a significant building project to extend its facilities. They could really do with someone with your financial expertise on the group that will lead this project and would be grateful if you would be willing to assist.

### ICAS Code of Ethics - Application of Conceptual Framework

At Section 120, the Code provides a conceptual framework that professional accountants shall apply to ensure adherence to the fundamental principles. The conceptual framework requires professional accountants to:

- (a) identify threats to compliance with the fundamental principles;
- (b) evaluate the threats identified; and
- (c) address the threats by eliminating them, or reducing them to an acceptable level by applying safeguards.

The Code also requires professional accountants to have an inquiring mind; to exercise professional judgement; and to apply the 'reasonable and informed third party test'.

An 'Analysis of the scenario' in relation to the identification, evaluation and addressing of the threats to objectivity in this situation is provided in turn below.

Documentation is encouraged throughout the decision-making process so that there is a record of the matters taken into consideration in reaching the judgement and action.

#### (a) Identifying the threats to objectivity

The Code states that threats to compliance with the fundamental principles fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgement or behaviour;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgement made, or an activity performed by the accountant or by another individual within the accountant's firm or employing organisation, on which the accountant will rely when forming a judgement as part of performing a current activity;
- (c) Advocacy threat – the threat that a professional accountant will promote a client's or employing organisation's position to the point that the accountant's objectivity is compromised;
- (d) Familiarity threat – the threat that due to a long or close relationship with a client, or employing organisation, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

## ***Analysis of the scenario***

The following potential threats to the fundamental principle of objectivity might exist as a result of your involvement with your client:

- Potential self-interest threat.
- Potential self-review threat.
- Potential familiarity threat.

Section 280 of the ICAS Code of Ethics states that an independent examiner shall comply with the independence requirements of the respective regulator:

“R280.1 A professional accountant in business acting as an independent examiner for a charity which is registered with a UK Charity regulator (i.e. The Charity Commission for England and Wales, The Office of the Scottish Charity Regulator (OSCR) or the Charity Commission for Northern Ireland) shall comply with the independence requirements of the respective regulator and is specifically scoped out of the requirements of Part 4A of this Code.”

For example, the OSCR guidance “Independent Examination: A Guide for Independent Examiners” - <https://www.oscr.org.uk/guidance-and-forms/independent-examination-a-guide-for-independent-examiners/> - states the following:

“It is critical that an independent examination is carried out by someone who is independent of the charity, and seen to be so. Independence is not possible if you are:

- one of the charity’s trustees
- anyone else involved in the management, control or administration of the charity, which usually means being a senior employee of the charity. However, there are also occasions where a volunteer (other than a trustee) also has a key role and so would not be independent.”

You must also ensure adherence to the specific requirement contained within Section 370 of the ICAS Code of Ethics which states:

### **“Family, other personal or business relationships**

Objectivity might be subject to a self-interest threat where a mutual business interest exists with a client or any officer or employee of the client. In such circumstances safeguards shall be applied and adequate disclosure of any conflict of interest shall be made to all relevant parties.

Professional accountants who hold office in a client company or have a comparable business relationship with a client, shall be aware of the dangers inherent in seeking to combine such a role with that of business adviser or other professional service having regard to the self-interest threat to their objectivity. In such circumstances, professional accountants shall be aware of the distinctive nature of each of the roles in which they are professionally engaged, and employ safeguards, including disclosure where appropriate.”

## **(b) Evaluating the threats to objectivity**

### ***Matters to consider***

- What are the nature of the services being provided to the client?
  - The threats to objectivity created by you being involved with the group who is managing the building project as well as undertaking the independent examination is high.
  - Whether the risk to objectivity can be reduced to an acceptable level will be dependent upon the specific facts and circumstances, including the nature of the particular engagement.

- Reasonable and informed third party test
  - The reasonable and informed third party test is very important - what is the likely 'third party' perception of you having a personal interest in a client?
  - It is not whether you believe that you can be objective but whether a reasonable and informed third party would conclude that you are objective.
  - This test is particularly key when a firm is expressing an opinion and a third party could reasonably assume that the firm is independent.
  - If a reasonable and informed third party would conclude that you would not be objective then the appointment, or engagement, should not be initiated.
- Capacity in which the professional accountant is acting
  - All parties need to be clear as to the capacity in which the professional accountant is acting - does your client see you as an adviser, or having a compliance role?
  - The knowledge of the stakeholders as to the facts and circumstances needs to be considered.
  - Consideration needs to be given to what outputs (e.g. reports) are being provided, if any, and are they being provided to external stakeholders such as bankers etc.
- Family, or other personal or business, arrangements
  - Family, or personal, loyalties can pose a particularly significant threat to objectivity.
  - Professional responsibilities could conflict with personal allegiances.

### ***Analysis of the scenario***

Whilst you carry out Independent Examinations for your client, which are specifically scoped out of the requirements for auditors in the Code, you must adhere to the independence requirements of the respective charity regulator. For example, it states in the OSCR guidance:

"It is critical that an independent examination is carried out by someone who is independent of the charity, and seen to be so."

The reasonable and informed third party test needs to be considered - what is the likely 'third party' perception of you being involved with the charity in relation to its building project?

### **(c) Addressing the threats to objectivity**

When threats are identified as not being at an acceptable level, the Code requires the professional accountant to address those threats by eliminating them or reducing them to an acceptable level. Threats are addressed by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (c) Declining or ending the specific professional activity.

Safeguards are defined in the Code as specific actions which directly target and address the threat in question. For example:

- A safeguard may include an appropriate independent party reviewing the work of the professional accountant.
- Transparency may be a possible safeguard – the disclosure of the financial interest, or close relationship, to any relevant parties.

***Analysis of the scenario***

It is very likely that an objective, reasonable and informed third party could reasonably conclude that your participation on this group might compromise your independence and no safeguards would be available.

This would be a judgement call depending on the facts and circumstances and your particular involvement in the project - the closer your involvement in the building project is to decision making the higher the risk to objectivity.

## Case Study 7: General practitioner – Independent examiner's spouse asked to be trustee of charity client

You are a partner in a CA firm. One of your clients is a small charity. You perform the Independent Examination for this client. Your spouse has been invited to be a trustee of the charity.

### ICAS Code of Ethics - Application of Conceptual Framework

At Section 120, the Code provides a conceptual framework that professional accountants shall apply to ensure adherence to the fundamental principles. The conceptual framework requires professional accountants to:

- (a) identify threats to compliance with the fundamental principles;
- (b) evaluate the threats identified; and
- (c) address the threats by eliminating them, or reducing them to an acceptable level by applying safeguards.

The Code also requires professional accountants to have an inquiring mind; to exercise professional judgement; and to apply the 'reasonable and informed third party test'.

An 'Analysis of the scenario' in relation to the identification, evaluation and addressing of the threats to objectivity in this situation is provided in turn below.

Documentation is encouraged throughout the decision-making process so that there is a record of the matters taken into consideration in reaching the judgement and action.

#### (a) Identifying the threats to objectivity

The Code states that threats to compliance with the fundamental principles fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgement or behaviour;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgement made, or an activity performed by the accountant or by another individual within the accountant's firm or employing organisation, on which the accountant will rely when forming a judgement as part of performing a current activity;
- (c) Advocacy threat – the threat that a professional accountant will promote a client's or employing organisation's position to the point that the accountant's objectivity is compromised;
- (d) Familiarity threat – the threat that due to a long or close relationship with a client, or employing organisation, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

#### ***Analysis of the scenario***

The following potential threats to the fundamental principle of objectivity might exist as a result of your involvement with your client:

- Potential self-interest threat.
- Potential familiarity threat.

Section 280 of the ICAS Code of Ethics states that an independent examiner shall comply with the independence requirements of the respective regulator:

“R280.1 A professional accountant in business acting as an independent examiner for a charity which is registered with a UK Charity regulator (i.e. The Charity Commission for England and Wales, The Office of the Scottish Charity Regulator (OSCR) or the Charity Commission for Northern Ireland) shall comply with the independence requirements of the respective regulator and is specifically scoped out of the requirements of Part 4A of this Code.”

For example, the OSCR guidance “Independent Examination: A Guide for Independent Examiners” - <https://www.oscr.org.uk/guidance-and-forms/independent-examination-a-guide-for-independent-examiners/> - states the following:

“It is critical that an independent examination is carried out by someone who is independent of the charity, and seen to be so.”

You must also ensure adherence to the specific requirement contained within Section 370 of the ICAS Code of Ethics which states:

#### **“Family, other personal or business relationships**

Objectivity might be subject to a self-interest threat where a mutual business interest exists with a client or any officer or employee of the client. In such circumstances safeguards shall be applied and adequate disclosure of any conflict of interest shall be made to all relevant parties.

Professional accountants who hold office in a client company or have a comparable business relationship with a client, shall be aware of the dangers inherent in seeking to combine such a role with that of business adviser or other professional service having regard to the self-interest threat to their objectivity. In such circumstances, professional accountants shall be aware of the distinctive nature of each of the roles in which they are professionally engaged, and employ safeguards, including disclosure where appropriate.”

## **(b) Evaluating the threats to objectivity**

### ***Matters to consider***

- What are the nature of the services being provided to the client?
  - The threats to objectivity by your spouse becoming a trustee of your charity client is high.
  - Whether the risk to objectivity can be reduced to an acceptable level will be dependent upon the specific facts and circumstances of the particular engagement.
- Reasonable and informed third party test
  - The reasonable and informed third party test is very important - what is the likely ‘third party’ perception?
  - It is not whether you believe that you can be objective but whether a reasonable and informed third party would conclude that you are objective.
  - This test is particularly key when a firm is expressing an opinion and a third party could reasonably assume that the firm is independent.
  - If a reasonable and informed third party would conclude that you would not be objective then the appointment, or engagement, should not be initiated.
- Capacity in which the professional accountant is acting
  - All parties need to be clear as to the capacity in which the professional accountant is acting - does your client see you as an adviser, or having a compliance role?
  - The knowledge of the stakeholders as to the facts and circumstances needs to be considered.
  - Consideration needs to be given to what outputs (e.g. reports) are being provided, if any, and are they being provided to external stakeholders such as bankers etc.
- Family, or other personal or business, arrangements
  - Family, or personal, loyalties can pose a particularly significant threat to objectivity.
  - Professional responsibilities could conflict with personal allegiances.

### ***Analysis of the scenario***

Whilst you carry out Independent Examinations for your client, which are specifically scoped out of the requirements for auditors in the Code, you must adhere to the independence requirements of the respective charity regulator. For example, it states in the OSCR guidance:

“... independence can also be compromised by being ‘connected’ to the charity. Such a connection can arise because of:

- a family relationship. For example, you may be the parent or child of a trustee or senior employee.
- a financial or commercial relationship. For example, you represent a body which funds the charity or the charity contracts with you to provide it with certain services other than independent examination
- a connection with a trustee. For example someone who was employed by a trustee, or managed by a trustee (even in another organisation) would not be independent of the charity’s trustees
- a prior connection to the charity. For example someone who had recently stepped down as a trustee or from a senior role in the charity would not be independent.”

The reasonable and informed third party test needs to be considered - what is the likely ‘third party’ perception of your spouse being a trustee for a charity client for which you are the Independent Examiner?

### **(c) Addressing the threats to objectivity**

When threats are identified as not being at an acceptable level, the Code requires the professional accountant to address those threats by eliminating them or reducing them to an acceptable level.

Threats are addressed by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or
- (c) Declining or ending the specific professional activity.

Safeguards are defined in the Code as specific actions which directly target and address the threat in question. For example:

- A safeguard may include an appropriate independent party reviewing the work of the professional accountant.
- Transparency may be a possible safeguard – the disclosure of the financial interest, or close relationship, to any relevant parties.

### ***Analysis of the scenario***

It is very likely that an objective, reasonable and informed third party could reasonably conclude that your spouse being appointed as a trustee of your charity client for which you are the Independent Examiner might compromise your independence and no safeguards would be available.



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