



Guidance to the ICAS Code of Ethics:

Objectivity - Financial
interests in, or relationships
with, clients

May 2023 - Abridged Version



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1. Introduction

There are clear threats to objectivity when an ICAS Member, 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.

ICAS has published the 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. The 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 its Appendix by way of illustration.

For convenience, this abridged document provides a summary of the key points within the full guidance paper.

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: integrity; objectivity; professional competence and due care; confidentiality; and professional behaviour.

The fundamental ethics principle of objectivity is defined in the Code as follows:

"Objectivity – to exercise professional or business judgement 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."

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'.

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".

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

There are obvious 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. The threats need to be carefully considered prior to any such interests or relationships being initiated.

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 are summarised below. Further discussion around these factors, and case studies, can be found in the full guidance paper.

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 so that there is a record of the matters taken into consideration in reaching the judgement and action.

Financial interests and/or relationships with clients - factors to consider

Nature of the services being provided to the client

- The self-interest threat to objectivity created by a firm or individual professional accountant (or any of that individual's immediate family) having a loan, or guaranteeing a loan, with a client is ordinarily high. Similarly, if the professional accountant has an investment in a client. 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, in certain situations, the nature of the services a firm provides might enable objectivity to be safeguarded. For example, 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.

- Whether or not the risk to objectivity of having a loan or investment with a client can be reduced to an acceptable level will be very much 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 of your firm having a financial, and/or personal, interest in a client? 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.
- A professional accountant who provides an assurance service must be independent of their assurance client, however, in relation to a situation where services other than assurance services are provided to a client, the Code does not specifically prohibit professional accountants from being a director in a client company or from investing in a client, provided appropriate safeguards are in place (see further discussion below on safeguards) and the value of any investment is not material to the financial circumstances of the professional accountant.
- Objectivity must be carefully considered before accepting directorships, or shareholdings in, client companies, with particular regard to 'the reasonable and informed third party' test. 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 but whether a reasonable and informed third party would conclude that you are objective.
- 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.
- 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 services being provided.

Materiality

- 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, also 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 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?
- 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.
- The knowledge of the stakeholders as to the facts and circumstances needs to be considered.

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 the dangers inherent in seeking to combine such a role with that of business adviser or the provision of another professional service.
- Professional accountants also need to remain alert to the potential threats to objectivity arising from immediate family members having relationships with clients.

Safeguards

- When threats are identified as not being at an acceptable level, the conceptual framework 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.
- 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.



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