

**Audit Committee News**

Edition 57 / Q2 2017 / Corporate Governance

# External audit

## **Audit Committee Handbook Chapter 6 – Part 3**

This chapter is the third part of the chapters covered in the Audit Committee News – Edition 55 & 56.



## Safeguarding auditor independence

The external auditor should remain independent and objective at all times. The audit committee should, at least annually, consider the external auditor's independence and carry out procedures to help ensure the auditor's independence and objectivity, taking into consideration relevant professional and regulatory requirements. For its part, the audit firm should have internal policies and procedures in place, which are properly monitored, to establish that the audit firm and its individual members are independent from the organisation.

In considering matters that may bear on the auditor's independence, both the auditor and the audit committee should consider whether conflicts exist, such as:

- the auditor holding a financial interest, either directly or indirectly, in the organisation;
- personal and business relationships of the auditor's immediate family, close relatives and partners with the organisation;
- the nature of the relationship between the audit partner and the CEO and/or the CFO;
- economic dependence by the auditor through its relationship with the organisation; and
- the nature and extent of services provided by the auditor in addition to the audit engagement.

Each year the audit committee should obtain from the audit firm information about policies and processes for maintaining independence and monitoring compliance with relevant requirements, including current requirements regarding the rotation of audit partners. The audit committee should understand the audit firm's plans for audit partner rotation on its engagement and engage in discussions relating to succession.

## Employment of former employees of the external auditor

The audit committee should agree on a policy for the employment of former employees of the statutory auditor, taking into account the relevant ethical guidelines governing the accounting profession and any local regulation or recommendations.

The audit committee should monitor application of the policy, including the number of former employees of the statutory auditor currently employed in senior positions in the organisation, and consider whether, in the light of their employment, there has been any impairment, or appearance of impairment, of the auditor's judgement or independence.

Particular attention should be given to members of the audit team moving directly to the organisation and former employees moving into financial oversight positions within the organisation. In both cases, the audit committee might consider "cooling off" periods to be necessary.

## Pre-approving non-audit services

To help ensure that non-audit services provided by the statutory auditor do not impair, or appear to impair, the auditor's independence or objectivity, the audit committee should develop, and recommend to the board, a policy on the provision and pre-approval of all non-audit services; and keep that policy under review.

In determining the policy, the audit committee should consider:

- whether the skills and experience of the statutory audit firm make it a suitable supplier of the non-audit service;
- whether there are safeguards in place to eliminate or reduce to an acceptable level any threat to audit objectivity and independence (see overleaf);
- the nature of the non-audit services;
- the fees incurred, or to be incurred, for non-audit services both for individual services and in aggregate, relative to the audit fee; and
- the criteria which govern the compensation of the individuals performing the audit.

Threats to audit objectivity and independence may arise from:

- the auditor having a financial or other interest that might cause them to be reluctant to take actions that would be adverse to the interests of the audit firm or any individual in a position to influence the conduct and outcome of the audit (self-interest threat);
- the auditor (or others in the firm) performing non-audit services the results of which are reflected in the amounts included or disclosed in the financial statements of the audited entity (self-review threat);
- partners and employees of the audit firm making judgements or taking decisions on behalf of the management of the audited entity (management threat);
- the audit firm undertaking work that involves acting as advocate for the audited entity and supporting a position taken by management in an adversarial context (advocacy threat);
- the auditor being predisposed to accept or is insufficiently questioning of the audited entity's point of view (familiarity threat); and
- the auditor's conduct being influenced by fear or threats (intimidation threat).

The threats identified above mirror those set out in the Auditing Practices Board's (APB) Ethical Standard 5 (Revised) [Non-audit services provided to audit clients](#). The Standard provides requirements and guidance on specific circumstances arising from the provision of non-audit services by audit firms to their audit clients, which may create threats to the auditor's objectivity or perceived loss of independence. In particular it states that the audit engagement partner should ensure that those charged with governance of the audited entity (usually the audit

committee) are appropriately informed on a timely basis of:

- all significant facts and matters that bear upon the auditor's objectivity and independence, related to the provision of non-audit services, including the safeguards in place; and
- for listed companies, any inconsistencies between APB Ethical Standards and the company's policy for the supply of non-audit services by the audit firms and any apparent breach of that policy.

It is good practice that the non-audit services policy devised by the audit committee should formally specify the types of non-audit work (if any):

- for which the use of the external auditor is pre-approved (i.e. approval has been given in advance as a matter of policy, rather than the specific approval of an engagement being sought before it is contracted);
- for which specific approval from the audit committee is required before they are contracted; and
- from which the external auditor is excluded.

Pre-approval of the use of the statutory auditor may be appropriate where the threats to auditor independence are considered low, for example if the engagement is routine in nature and the fee is not significant in the context of the audit fee, or for an audit related service.

Those non-audit services for which specific approval from the audit committee is required before they are contracted are likely to include those which are thought to give rise to threats to the auditor's independence because of their size or nature or because of special terms and conditions (for example, contingent fee arrangements). Where contracting such services from the audit firm, audit committees should give careful consideration as to whether any safeguards to be put in place by the audit firm are likely to be effective.

It is good practice to disclose a summary of the non-audit services policy in the annual report.

## Audit related services

Audit related services include inter alia:

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

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received, or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. The scope of any potential collaboration with audit clients is defined by regulatory requirements governing auditor independence.

© 2017 KPMG AG is a subsidiary of KPMG Holding AG, which is a member of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss legal entity. All rights reserved.