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Compared to April 2011 Version**

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COUNCIL INTERPRETATIONS TO RULES 204.1 TO 204.6

INTRODUCTION

- 1 It is a fundamental principle of the practice of Chartered Accountancy that a member who provides assurance services shall do so with unimpaired professional judgment and objectivity, and shall be seen to be doing so by a reasonable observer. This principle is the foundation for public confidence in the reports of assurance providers.
- 2 The confidence that professional judgment has been exercised depends on the unbiased and objective state of mind of the reporting accountant, both in fact and appearance. Independence is the condition of mind and circumstance that would reasonably be expected to result in the application by a member of unbiased judgment and objective consideration in arriving at opinions or decisions in support of the member's report. A member or firm is not considered to be independent if the member or firm does not comply with the provisions of Rules 204.1 to 204.4.
- 3 Rule 204.1 provides that a member or firm who engages or participates in an engagement:
 - (a) to issue a written communication under the terms of any assurance engagement; or
 - (b) to issue a report on the results of applying specified auditing procedures;must be independent of the client. Independence requires the avoidance of situations which impair the professional judgment or objectivity of the member, firm or a member of the firm or which, in the view of a reasonable observer, would impair that professional judgment or objectivity.
- 4 Rule 204.2 provides that a member or firm, who is required to be independent pursuant to Rule 204.1 in respect of a particular engagement, must comply with Rules 204.3 and 204.4.
- 5 Rule 204.3 provides that a member or firm, who is required to be independent pursuant to Rule 204.1 in respect of a particular engagement, must identify and evaluate threats to independence and, if they are not clearly insignificant, identify and apply safeguards to reduce them to an acceptable level. Where safeguards are not available to reduce the threats to an acceptable level the member or firm must eliminate the activity, interest or relationship creating the threats, or refuse to accept or continue the engagement. ~~Rule 204.3 requires the member or firm to document compliance with Rule 204.2.~~
- ~~5~~ Rule 204.4 describes circumstances and activities which members and firms must avoid when performing assurance and specified auditing procedure engagements because adequate safeguards will not exist that will, in the view of a reasonable observer, eliminate the threat or reduce it to an acceptable level, as required by Rule 204.3~~2~~. The requirements to avoid these circumstances and activities are referred to as "prohibitions."
- 6 Rule 204.5 requires a member or firm to document compliance with Rules 204.3, 204.4(24), 204.4(34)(b), 204.4(35) and 204.4(40).

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- 7 Rule 204.6 provides that a member or student must disclose breaches of the Rule to a designated partner in the firm. It also provides that, when a member or student has been assigned to an engagement team, the member or student must disclose to a designated partner any interest, relationship or activity that would preclude the member or student from being on the engagement team.
- Rule 204.~~76~~ provides that a firm must ensure that members of the firm comply with Rule 204.4. The Rule provides that a firm may~~shall~~ not permit a member of the firm to have a relationship with or an interest in an assurance client, or provide a service to an assurance client, which is precluded by Rule 204.
- 8 This Council Interpretation describes a conceptual framework of principles that members and firms should use to identify threats to independence and evaluate their significance. If the threats are other than clearly insignificant, the member or firm should identify available safeguards. Some safeguards may already exist within the structure of the firm or the client, while others may be created by the action of the member, firm or client. Safeguards should be identified and, where applicable, applied to eliminate the threats or reduce them to an acceptable level. Members should exercise professional judgment to determine which safeguards to apply and whether the safeguards will permit the member or firm to accept or continue the engagement.
- 9 The effectiveness of safeguards largely depends on the culture of the particular firm. Therefore, the Council encourages leaders of firms to stress the importance of compliance with Rule 204 and emphasize the expectation that members of the firm will act in the public interest. In doing so, firms should create and monitor effective policies and procedures designed to preserve the independence of the firm and its partners and employees when required by Rule 204.
- 10 The examples presented herein are intended to illustrate the application of the principles; they are not, nor should they be interpreted as, an exhaustive list of all circumstances that may create a threat to independence. Consequently, it is not sufficient for a member or ~~a~~ firm merely to comply with the examples presented. Rule 204.~~32~~ requires that they apply the principles to any particular circumstance encountered, whether or not the examples used in the Council Interpretation, or the prohibitions set out in Rule 204.4, reflect those circumstances.
- 11 These examples describe specific circumstances and relationships that may create threats to independence. They also describe the safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level in each circumstance. While the examples relate to the audit or review of financial statements and other assurance engagements, they also apply to engagements to issue a report on the results of applying specified auditing procedures as required by Rule 204.1(b).
- 12 This Council Interpretation sets out how, in the Council's opinion, a reasonable observer might view certain situations in the application of Rule 204.1 to 204.~~76~~. The reasonable observer is a hypothetical individual who has knowledge of the facts which the member knew or ought to have known, including the safeguards applied, and who applies judgment objectively, with integrity and due care. Members should also refer to the Foreword to the Rules, which provides the rationale for establishing the reasonable

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observer principle.

- 13 Members are reminded that for the purposes of Rules 204.1 to 204.~~76~~, independence includes both independence of mind and independence in appearance. As stated in Rule 204.1, independence requires the absence of any influence, interest or relationship which would impair the professional judgment or objectivity of the member or a member of the firm or which, in the view of a reasonable observer, would impair the professional judgment or objectivity of the member or a member of the firm. Frequently it is appearance of independence, or lack thereof, that poses the greatest challenge. In all situations, members should reflect on the wording of the Rule and Council Interpretation to ensure compliance with the spirit and intent of the Rule and Council Interpretation.
- 14 If, after considering the rules and this Council Interpretation, members are uncertain as to their correct application, they are encouraged to discuss the matter with partners, professional colleagues or Institute staff. Members may also request the view of [name of appropriate committee].
- 15 Members should also be cognizant of any relevant Canadian or foreign legislation that may preclude a member from accepting or continuing an engagement. Members are cautioned that legislation under which corporations and other enterprises are incorporated or governed may impose differing requirements in respect of independence. Members should satisfy both the requirements of any governing legislation and these Rules of Professional Conduct.
- 16 Members and firms are reminded that Rules 204.~~87~~ and 204.~~98~~ deal respectively with independence standards for insolvency engagements and the requirement to disclose when the appearance of independence may be lacking in other engagements.

THE FRAMEWORK

- 17 The objective of this Council Interpretation is to assist members and firms in:
 - (a) identifying and evaluating threats to independence; and
 - (b) identifying and applying appropriate safeguards to eliminate or reduce the threat or threats to an acceptable level in instances where their cumulative effect is not clearly insignificant.

This Council Interpretation also describes those situations referred to in Rule 204.4 where safeguards are not available to reduce a threat or threats to an acceptable level, and the only possible actions are to eliminate the activity, interest or relationship creating them, or to refuse to accept or continue the assurance engagement.
- 18 The use of the word “independence” on its own may create misunderstandings. Standing alone, the word may suggest that a person exercising professional judgment ought to be free from all economic, financial and other relationships. This is impossible, as everyone has relationships with others. Therefore, members should evaluate the significance of economic, financial and other relationships in the light of what a reasonable observer would conclude to be acceptable in maintaining independence.
- 19 In making this evaluation, many different circumstances may be relevant. Accordingly, it is impossible to define every situation that creates a threat to independence and specify

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the appropriate mitigating action. In addition, because of differences in the size and structure of firms, the nature of assurance engagements and client entities different threats may exist, that require the application of different safeguards. A conceptual framework that requires members and firms to identify, evaluate and address threats to independence, rather than merely comply with a set of specific and perhaps arbitrary rules, is, therefore, in the public interest.

- 20** Based on such an approach, this Council Interpretation describes a conceptual framework of principles for compliance with Rules 204.1 to 204.76. Members, firms and network firms should use this conceptual framework to identify threats to independence, to evaluate their significance and, if they are other than clearly insignificant, to identify and apply safeguards to eliminate them or reduce them to an acceptable level, so that independence ~~in~~ fact and appearance are not impaired. In addition, consideration should be given to whether relationships between members of the firm who are not on the engagement team and the assurance client may also create threats to independence. Where safeguards are not available to reduce threats to an acceptable level, the member, firm or network firm should eliminate the activity, interest or relationship creating the threats, or the member or firm should refuse to accept or continue the particular engagement.
- 21** Rule 204.1 requires members and firms to be independent in fact and in appearance. The requirement to comply with the specific prohibitions set out in Rule 204.4 does not relieve a firm from complying with Rules 204.1 and 204.32 and the need to apply the conceptual framework and determine on a principles-based approach whether or not the firm is independent with respect to all assurance engagements, including audit and review engagements.
- 22** Rule 204.1 and, therefore, the principles in this Council Interpretation apply to all assurance engagements and engagements to issue a report on the results of applying specified auditing procedures. The nature of the threats to independence and the applicable safeguards necessary to eliminate them or reduce them to an acceptable level will differ depending on the particulars of the engagement. Differences in threats and safeguards will arise, for example, if the engagement is an audit or review engagement or another type of assurance engagement; and, in the case of an assurance engagement that is not an audit or review engagement, in the purpose, subject matter and intended users of the report. Members and firms should, therefore, evaluate the relevant circumstances, the nature of the engagement and the entity, the threats to independence and the adequacy of available safeguards in deciding whether it is appropriate to accept or continue an engagement, and whether a particular person should be on the engagement team.
- 23** For audit clients and review clients, the persons on the engagement team, the firm and network firms should be independent of the client. In the case of an assurance engagement where the client is neither an audit nor a review client, those on the engagement team and the firm should be independent of the client. In addition, in the case of an engagement that is not an audit or review engagement, consideration should be given to any threats the firm has reason to believe may be created by the interests and relationships of network firms.
- 24** The term “firm” means a sole practitioner, partnership or association of members who

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carries or carry on the practice of public accounting, or carries or carry on related activities as defined by the Council. A related activity includes a related business or practice that is cross-referenced with a practice of public accounting or with any other business or practice which is cross-referenced with a practice of public accounting in accordance with By-law [number of appropriate By-law]. In those jurisdictions where a member or ~~a~~-firm may practice in a corporate form, firm includes a professional corporation.

NETWORK FIRMS

- 25** The references to “firms” and “network firms” in Rules 204.1 to 204.~~76~~ and this Council Interpretation should be read as referring to those entities themselves and not to the persons who are partners or employees thereof.
- 26** ~~34~~ Rules 204.1 to 204.4 and this Council Interpretation bring the independence of a network firm into consideration when evaluating the independence of a member or firm for an assurance audit or review engagement. It is the member’s or firm’s responsibility to determine whether the network firm and its members have any interests or relationships or provide any services that would create threats to independence.
- 26A** A firm may participate in a larger structure with other firms and entities to enhance its ability to provide professional services. Whether the agreements and relationships among the firms and entities that are part of such a larger structure are such that any of the firms or entities is a network firm depends on the particular facts and circumstances. The geographic location of the firms and entities, either within or outside of Canada, is irrelevant as to whether such a larger structure exists. Whether the firms and entities are legally separate from each other is not determinative, in and of itself, of whether such a larger structure exists.
- 26B** Another firm or entity will not be considered to be network firm simply by virtue of the existence of one of the following arrangements between that other firm or entity and the firm itself:
- (a) the sharing of costs that are immaterial to the firm that is performing the particular engagement;
 - (b) an association with the other firm or entity to provide a service or develop a product on a joint basis;
 - (c) co-operation to facilitate the referral of work or solely to respond jointly to a request for a proposal for the provision of a professional service;
 - (d) references on stationery or in promotional materials to an association with other firms or entities that does not constitute a larger structure of co-operating firms or entities as described in the definition of network firm; or
 - (e) the use of a common name when an agreement in relation to the sale of a component of a firm or entity provides that each of the transacting firms or entities may use the existing name for a limited period of time.
- 26C** The definition of a network firm refers to co-operating entities that share significant professional resources. Shared professional resources may be considered to be significant where there is an exchange of people or information, such as where staff is

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drawn from a shared pool, or a common technical department is created within a larger structure to provide participating firms or entities with technical advice that they are required to follow. Shared professional resources will not be considered to be significant when they are limited to common audit methodology or audit manuals or a shared training endeavour, with no exchange of personnel or client or market information. Similarly, the sharing of costs limited only to the development of such common audit methodology, audit manuals or a shared training endeavour will not be considered to give rise to a network firm relationship.

ENGAGEMENTS THAT ARE NOT AUDIT OR REVIEW ENGAGEMENTS

- 27** An engagement to report on the results of applying specified auditing procedures is not an assurance engagement as contemplated in the *CICA Handbook – Assurance*. However, for the purposes of Rules 204.1 to 204.76 and this Council Interpretation, the principles contained herein applicable to an assurance engagement, other than an audit or review engagement, also apply to an engagement to report on the results of applying specified auditing procedures. In so applying those principles, the reference to an assurance client is to be read as a reference to a client where the engagement is to report on the results of applying specified auditing procedures.
- 28** In the case of an assurance report to an assurance client that is not an audit client or a review client where the report is intended only for the use of identified users, as contemplated by the *CICA Handbook – Assurance*, the users of the report are considered to be knowledgeable as to the purpose, subject matter and limitations of the report. Users gain such knowledge through their participation in establishing the nature and scope of the member's or firm's engagement, including the criteria by which the particular subject matter is to be evaluated. The member's or firm's knowledge and enhanced ability to communicate about safeguards with all the report's users increase the effectiveness of safeguards to independence in appearance. Therefore, the member or firm may take these circumstances into account when evaluating the threats to independence and considering the applicable safeguards necessary to eliminate them or reduce them to an acceptable level. With respect to network firms, limited consideration of any threats created by their interests and relationships may be sufficient.

EXTENT OF APPLICATION OF REQUIREMENT FOR INDEPENDENCE FOR DIFFERENT TYPES OF ENGAGEMENT

- 29** The effect of Rules 204.1 to 204.76 is that:
- (a) For an assurance engagement for a client that is an audit or review client, those on the engagement team, the firm and network firms are required to be independent of the client.
 - (b) For an assurance engagement for a client that is not an audit or review client, when the assurance report is not intended only for the use of identified users, those on the engagement team and the firm are required to be independent of the client.
 - (c) For an assurance engagement for a client that is not an audit or review client, when the assurance report is intended only for the use of identified users, those on the engagement team are required to be independent of the client. In addition, the firm should not have a material direct or indirect financial interest in the client.

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30 ~~*Intentionally left blank.*The threats and safeguards identified in this Council Interpretation are generally discussed in the context of interests or relationships between the firm, a network firm, those on the engagement team and the assurance client. In the case of an audit or review client the prohibitions with respect to financial interests, are extended to related entities of the client and in the case of an audit client that is a reporting issuer, the prohibitions with respect to the provision of non-assurance services are extended to related entities of the audit client. For assurance clients other than audit and review clients, when the engagement team has reason to believe that a related entity of the client is relevant to the evaluation of the firm's independence, the engagement team should consider that related entity when evaluating threats to independence and applying appropriate safeguards.~~

RELATED ENTITIES

31 For the purposes of Rules 204.1 to 204.76 "related entity" is a defined term that is dependent on the nature of the assurance engagement, the nature of the client and the relationship between the client and the other entity. The circumstances in which another entity is defined to be a related entity of an assurance client are outlined below:

- ~~_____ a related entity of a client that is a reporting issuer means:~~
- ~~an entity that has control over a client;~~
 - ~~an entity over which the client has control;~~
 - ~~an entity which is under common control with the client;~~
 - ~~an entity over which the client has significant influence, unless the entity is not material to the client; and~~
 - ~~an entity which has significant influence over the client, unless the client is not material to the entity.~~

~~_____ The definition of a related entity for a client that is not a reporting issuer excludes from the above an entity that has control over the client if the client is not material to the entity, and entity under common control with the client if both the client and the entity under common control are not material to the entity that controls them~~

<u>Definition reference</u>	<u>Test</u>	<u>Reporting issuer or listed entity client</u>	<u>Audit or review client that is not a reporting issuer or listed entity</u>	<u>Non-audit, non-review assurance client</u>
<u>(a)(i)</u> <u>(b)(i)</u> <u>(c)(i)</u>	<u>The entity is controlled by the client.</u>	<u>Related</u>	<u>Related</u>	<u>Conditional*</u>
<u>(a)(ii)&(iii)</u> <u>(b)(ii)(A)&(B)</u> <u>(c)(ii)&(iii)</u>	<u>The entity has either control (ii) or significant influence (iii) over the client and the client is material to the entity.</u>	<u>Related</u>	<u>Conditional*</u>	<u>Conditional*</u>
<u>(a)(iv)</u> <u>(b)(ii)(C)</u>	<u>The entity and the client are both</u>	<u>Related</u>	<u>Conditional*</u>	<u>Conditional*</u>

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<u>(c)(iv)</u>	<u>controlled by a second entity and both the client and the first entity are material to the controlling second entity.</u>			
<u>(a)(v)</u> <u>(b)(ii)(D)</u> <u>(c)(v)</u>	<u>The entity is subject to significant influence by the client and the entity is material to the client.</u>	<u>Related</u>	<u>Conditional*</u>	<u>Conditional*</u>

*An entity referred to in paragraphs (b)(ii)(A) to (D) and (c)(i) to (v) of the definition of “related entity”, as applicable, is a related entity if the engagement team knows or has reason to believe that an activity, interest or relationship involving the other entity is relevant to the evaluation of independence of the member or firm with respect to the assurance engagement. This condition is not intended to require the engagement team to undertake a search for such possible activities, interests or relationships with such entities.

321A In determining whether significant influence exists members should follow the guidance established in the *CICA Handbook – Accounting*. Ideally, the client’s related entities and the interests and relationships that involve the related entities should be identified in advance.

KEY AUDIT PARTNERS

32A A “key audit partner” is defined as an audit partner who is the lead engagement partner, the engagement quality control reviewer, and any other audit partner on the engagement team who makes important decisions or judgments on significant matters with respect to the audit or review engagement.

120C The provisions in Rule 204.4(20)(b) do not apply to A key audit partner does not include those “specialty” and “technical” partners who consult with others on the engagement team regarding technical or industry-specific issues, transactions or events, including ~~taxation~~tax matters. In addition, the provisions of Rules 204.4(20)(b) and 204.4(38) do not apply to those partners who, subsequent to the issuance of the audit report, provide quality control for the engagement. Such partners typically have a low level of involvement with senior management as well as a relatively low level responsibility for overall presentation in the financial statements.

32B A transitional provision has been introduced in relation to the adoption, in 2014, of the term “key audit partner”. This transitional provision will permit a person who was not required to rotate under the previous requirements to serve up to an additional two years in a key audit partner role before rotation is required.

RETIRED PARTNERS

33 A retired partner who retains a close association with the firm from which the partner has retired is considered to be a member of the firm for the purposes of Rules 204.1 to

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204.76 and the related Council Interpretation. Retired partners may have varying degrees of involvement with the firm. When a retired partner continues to provide administrative or client service for or on behalf of the firm, the partner may be closely associated with the firm. The following factors may indicate that the partner retains a close association with the firm:

- the nature and extent of the retired partner's client and administrative activities within the firm may be more than clearly insignificant and transitional;
- the retired partner holds a direct or indirect financial interest in the firm, including share-based retirement income that may fluctuate with the firm's income; and
- the retired partner is held out to be a member of the firm through, for example, having a separate, identified office on the firm's premises, acting as its spokesperson or representative, using a firm business card or having a listing in the firm's telephone directory for other than a predetermined period of time following retirement.

When evaluating whether a retired partner has a close association with the firm, consideration should be given to how a reasonable observer would regard the association.

- 34 ~~Intentionally left blank. Rules 204.1 to 204.4 and this Council Interpretation bring the independence of a network firm into consideration when evaluating the independence of a member or firm for an audit or review engagement. It is the member's or firm's responsibility to determine whether the network firm and its members have any interests or relationships or provide any services that would create threats to independence.~~

EVALUATING THREATS AND SAFEGUARDS

- 35 The ongoing evaluation and disposition of threats to independence should be supported by evidence obtained both before accepting an engagement and while it is being performed. The obligation to make such evaluation and take action arises when a member of a firm or network firm knows, or should reasonably be expected to know, of circumstances or relationships that might impair independence. There may be occasions when a member, a firm or a network firm is inadvertently in breach of a provision of Rule 204, ~~the principles in this Council Interpretation~~. If such an inadvertent breach occurs, it would generally not impair independence for the purposes of Rules 204.1 to 204.76, provided the firm had appropriate quality control policies and procedures in place to promote independence and, once discovered, the breach was corrected promptly and any necessary safeguards were applied. An inadvertent breach would include a situation where the member did not know of the circumstances that created the breach.

- 36 Rule 204.4 describes activities, interests or relationships that create threats to independence that are so significant that there are no safeguards available to reduce them to an acceptable level and, accordingly, prohibits the provision of assurance services, as specified, in conjunction with such activities, interests or relationships. Rules 204.1 to 204.76 and this Council Interpretation also describe the threats to independence and analyze safeguards that may be capable of eliminating them or reducing them to an acceptable level. ~~They~~ concludes with some examples of how ~~the~~ this conceptual framework to independence is to be applied to specific circumstances and relationships and the relevant threats and safeguards. The examples are not all

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inclusive. Professional judgment should be used to determine whether appropriate safeguards exist to eliminate all threats to independence or to reduce their cumulative effect to an acceptable level. In some examples, it may be possible to eliminate the threat or reduce it to an acceptable level by the application of safeguards. In some other examples, the threat or threats to independence will be so significant that the only possible actions are to eliminate the activity, interest or relationship creating the threat or threats, or to refuse to accept or continue the engagement

- 37** When a member or firm identifies a threat to independence that is not clearly insignificant, and the member or firm decides to apply appropriate safeguards and accepts or continues the assurance engagement, the decision should be documented in accordance with Rule 204.~~53~~. The documentation should include the following information:
- (a) a description of the nature of the engagement;
 - (b) the threat identified;
 - (c) the safeguard or safeguards identified and applied to eliminate the threat or reduce it to an acceptable level; and
 - (d) an explanation of how, in the member or firm's professional judgment, the safeguards eliminate the threat or reduce it to an acceptable level.
- 387** Throughout this Council Interpretation, reference is made to "significant" and "clearly insignificant". In considering the significance of any particular matter, qualitative as well as quantitative factors should be taken into account. A matter should be considered clearly insignificant only if it is both trivial and inconsequential.

THREATS TO INDEPENDENCE

- 39** Independence is potentially affected by self-interest, self-review, advocacy, familiarity and intimidation threats. The mere existence of such threats does not *per se* mean that the performance of a prospective engagement is precluded. The undertaking or continuation of an engagement is only precluded where safeguards are not available to eliminate or reduce the threats to an acceptable level or where Rule 204.4 provides a specific prohibition.
- 40** A **Self-Interest Threat** occurs when a firm or a person on the engagement team could benefit from a financial interest in, or other self-interest conflict with, an assurance client. Examples of circumstances that may create a self-interest threat include, but are not limited to:
- (a) a direct financial interest or material indirect financial interest in an assurance client;
 - (b) a loan or guarantee to or from an assurance client or any of its directors or officers;
 - (c) dependence by a firm, office or member on total fees from an assurance client;
 - (d) undue concern about the possibility of losing the engagement;
 - (e) evaluating performance or providing compensation ~~to an audit partner~~ for selling non-audit services to an assurance ~~audit~~ client;
 - (f) having a close business relationship with an assurance client; and
 - (g) potential employment with an assurance client.

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- 41 A **Self-Review Threat** occurs when any product or judgment from a previous engagement needs to be evaluated in reaching a conclusions on the particular assurance engagement, or when a person on the engagement team was previously an officer or director ~~or officer~~ of the client, or was ~~an employee~~ in a position to exert ~~direct and~~ significant influence over the subject matter of the assurance engagement.

Examples of circumstances that may create a self-review threat include, but are not limited to:

- (a) a person on the engagement team being, or having recently been, an officer or director ~~or officer~~ of the client;
- (b) a person on the engagement team being, or having recently been, an employee of the assurance client in a position to exert ~~direct and~~ significant influence over the subject matter of the assurance engagement, or another person having the duties or responsibilities normally associated with such an employee;
- (c) a member or firm performing services for an assurance client that directly affect the subject matter of the engagement; and
- (d) a member or firm preparing original data used to generate financial statements or preparing other records that are the subject matter of the engagement.

- 42 An **Advocacy Threat** occurs when a firm, or a person on the engagement team, promotes, or may be perceived to promote, an assurance client's position or opinion to the point that objectivity may be, or may be perceived to be, impaired. Such would be the case if a person on the engagement team were to subordinate his or her judgment to that of the client, or the firm were to do so. Examples of circumstances that may create an advocacy threat include, but are not limited to:

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

- 43 A **Familiarity Threat** occurs when, by virtue of a close relationship with an assurance client, its directors, officers or employees, a firm or a person on the engagement team becomes too sympathetic to the client's interests. Examples of circumstances that may create a familiarity threat include, but are not limited to:

- (a) a person on the engagement team having an immediate or close family member who is an officer or director ~~or officer~~ of the assurance client;
- (b) a person on the engagement team having an immediate or close family member who, ~~as an employee or shareholder of the assurance client,~~ is in a position to exert ~~direct and~~ significant influence over the subject matter of the assurance engagement;
- (c) a former partner of the firm being an officer or director, ~~officer or employee~~ of the assurance client or in a position to exert ~~direct and~~ significant influence over the subject matter of the assurance engagement;
- (d) the long association of a senior person on the engagement team with the assurance client; and

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(e) the acceptance of gifts or hospitality from the assurance client, its directors, officers or employees, unless the value thereof is clearly insignificant.

44 An **Intimidation Threat** occurs when a person on the engagement team may be deterred from acting objectively and exercising professional skepticism by threats, actual or perceived, from the directors, officers or employees of an assurance client. Examples of circumstances that may create an intimidation threat include, but are not limited to:

(a) the threat of being replaced due to a disagreement with the application of an accounting principle; and

(b) the application of pressure to inappropriately reduce the extent of work performed in order to reduce or limit fees.

SAFEGUARDS

45 Members and firms have an ongoing responsibility to comply with Rules 204.1 to 204.76 by taking into account the context in which they practise, the threats to independence and the safeguards which may be available to eliminate the threats or reduce them to an acceptable level. Safeguards fall into three broad categories:

(a) safeguards created by the profession, legislation or regulation;

(b) safeguards within the assurance client; and

(c) safeguards within the firm's own systems and procedures.

46 Safeguards created by the profession, legislation or regulation include the following:

(a) education, training and practical experience requirements for entry into the profession;

(b) continuing education programs;

(c) professional standards;

(d) external practice inspection;

(e) disciplinary processes;

(f) members' practice advisory services;

(g) participation by members of the public in oversight and governance of the profession; and

(h) legislation governing the independence requirements of the firm and its members.

47 Safeguards within the assurance client may include the following:

(a) employees of the client who are competent to make management decisions;

(b) policies and procedures that emphasize the client's commitment to fair financial reporting;

(c) internal procedures that ensure objective choices in commissioning non-assurance engagements; and

(d) an audit committee that provides appropriate oversight and communications regarding a firm's services.

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However, it is not possible to rely solely on safeguards within the assurance client to reduce threats to an acceptable level.

~~48~~ Where an audit committee does not exist, as is set out in the definition of “audit committee”, references in this Rule to an audit committee should be interpreted to refer to another governance body which has the duties and responsibilities normally granted to an audit committee or to those charged with governance for the entity. In some cases, this role may be filled by client management personnel. The *CICA Handbook – Assurance* requires members and firms to determine the appropriate person or persons within the entity’s governance structure with whom to communicate and establishes requirements for communication on matters relating to independence with such a person or persons.

~~48~~ When audit committees are independent of client management they can have an important corporate governance role and can assist the board of directors in satisfying themselves that a member or a firm is independent in carrying out its audit role. The requirements for annual communication with the audit committee on matters relating to independence are included in the *CICA Handbook – Assurance*.

~~49~~ *Intentionally left blank.* Firms should establish policies and procedures for independence-related communications with audit committees. Matters to be communicated will vary in each circumstance and should be decided by the firm, but should generally address the relevant matters set out in the *CICA Handbook – Assurance*.

50 Safeguards within the firm’s own systems and procedures may include firm-wide safeguards such as the following:

- (a) firm leadership that stresses the importance of independence and the expectation that persons on engagement teams will act in the public interest;
- (b) policies and procedures to implement and monitor quality control of assurance engagements;
- (c) documented independence policies regarding the identification of threats to independence, the evaluation of their significance and the identification and application of appropriate safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level;
- (d) internal policies and procedures, including annual reporting by members of the firm, to monitor compliance with firm policies and procedures as they relate to independence;
- (e) policies and procedures that will enable the identification of interests or relationships between the firm or those on the engagement team and assurance clients;
- (f) policies and procedures to monitor and manage the reliance on revenue received from a single assurance client;
- (g) internal performance measures that do not put excessive pressure on partners to generate non-assurance revenue from their assurance clients and do not over-emphasize budgeted hours;
- (h) using different partners and teams with separate reporting lines for the provision of

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non-assurance services to an assurance client;

- (i) policies and procedures to prohibit members of the firm who are not on the engagement team from influencing the outcome of the assurance engagement;
- (j) timely communication of a firm's policies and procedures, and any changes thereto, to all members of the firm, including appropriate training and education thereon;
- (k) designating a member of the firm's senior management as responsible for overseeing the adequate functioning of the safeguarding system;
- (l) means of advising all members of the firm of those clients and related entities from which they should be independent;
- (m) an internal disciplinary mechanism to promote compliance with firm policies and procedures; ~~or and~~
- (n) policies and procedures that empower members of the firm to communicate, without fear of retribution, to senior levels within the firm any issue of independence and objectivity that may concern them.

51 Safeguards within the firm's own systems and procedures may include engagement-specific safeguards such as the following:

- (a) involving another person to review the work done or advise as necessary. This person could be someone from outside the firm or network firm, or someone from within who was not otherwise associated with the engagement team. The person should be independent of the assurance client and will not, by reason of the review performed or advice given, be considered to be on the engagement team;
- (b) consulting a third party, such as a committee of independent directors, a professional regulatory body or a professional colleague;
- (c) rotating senior personnel on the engagement team;
- (d) discussing independence issues with the audit committee;
- (e) disclosing to the audit committee, the nature of services provided and extent of fees charged;
- (f) policies and procedures designed to ensure that persons on the engagement team do not make, or assume responsibility for, management decisions for the client;
- (g) involving another firm to perform or re-perform part of the assurance engagement;
- (h) involving another firm to re-perform the non-assurance service; ~~or and~~
- (i) removing a person from the engagement team, when that person's financial interests, relationships or activities create a threat to independence.

Practitioners with Small or Owner-Managed Clients

52 The size and structure of the firm and the nature of the assurance client and the engagement will affect the type and degree of the threats to independence and, consequently, the types of safeguards appropriate to eliminate such threats or reduce them to an acceptable level. For example, it is understood that not all the safeguards noted in paragraphs 47 - 51 will be available to the sole practitioner or small firm or within smaller clients such as owner-managed entities. Smaller clients often rely on members to provide a broad range of accounting and business services. Independence will not be

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impaired provided such services are not specifically prohibited by Rule 204.4 and provided safeguards are applied to reduce any threat to an acceptable level. In many circumstances, explaining the result of the service and obtaining client approval and acceptance for the result of the service will be an appropriate safeguard for such smaller entities. Similarly, such clients often have a long-standing relationship with an individual who is a sole practitioner or partner from a firm. Independence will not be impaired provided safeguards are applied to reduce any familiarity threat to an acceptable level. In most circumstances, periodic external practice inspection and, where appropriate, consultation will reduce any threat to independence to an acceptable level.

ENGAGEMENT PERIOD

53 The firm and those on the engagement team should be independent of the assurance client during the period of the assurance engagement. This period starts at the earlier of the date when the member or firm signs the engagement letter or commences procedures in respect of the engagement ~~engages to perform the assurance service~~ and ends when the assurance report is issued, except when the engagement is of a recurring nature. If the assurance engagement is expected to recur, the engagement period ends with the notification by either party that the professional relationship has terminated or the issuance of the final assurance report, whichever is later. In the case of an audit engagement for a reporting issuer or listed entity the engagement period ends when the audit client or the firm notifies the relevant Securities Commission that the audit client is no longer an audit client of the firm.

54 In the case of an audit or review engagement, independence is also required during the period covered by the financial statements reported on by the member or firm. When an entity becomes an audit or review client during or after the period covered by the financial statements on which that the member or firm will report ~~on~~, the member or firm should consider whether any threats to independence may be created by:

(a) ~~financial or business relationships with the client during or after the period covered by the financial statements, but prior to the acceptance of the engagement;~~

~~(b) previous services provided to the client.~~

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

55 If a non-assurance service was provided to an audit or review client during or after the period covered by the financial statements but before the engagement period commencement of professional services in connection with the audit or review engagement and the non-assurance service would have been prohibited by the provisions of Rules 204.4(22) to (34) in relation to the performance of an audit or review engagement for the client, the provisions of Rule 204.4(35) apply. Rule 204.4(35)(a) requires the member or firm to: ~~and the non-assurance service would impair independence if it had been provided during the period of the audit or review engagement, consideration should be given to the threats to independence, if any, arising from the provision of the non-assurance service. If a threat is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:~~

(a)(i) discussing independence issues related to the provision of the non-assurance

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service with the audit committee;

(b)(ii) require~~ing~~ the client to review and accept responsibility for the results of the non-assurance service; and

(c)(iii) preclude~~ing~~ personnel who provided the non-assurance service from participating in the audit or review engagement; and

such that any threat created by the provision of the non-assurance service is reduced to an acceptable level.

The determination as to whether any such threat has been so reduced will require the member or firm to consider the nature and impact of the threat to independence and take any further measures that are necessary to reduce it to an acceptable level. Such further measures might include engaging another firm to review the results of the non-assurance service or having another firm re-perform that service to the extent necessary to enable the other firm to take responsibility for the non-assurance service.

If adequate safeguards are not available to reduce a the provision of the non-assurance service creates such a significant threat to independence that compliance with the requirements of Rule 204.4(35)(a) would still not reduce any such threat to an acceptable level, the member or firm is required to ~~should~~ decline the audit or review engagement.

Members and firms are also reminded that, even where a non-assurance service that is not specifically addressed by the provisions of Rules 204.4(22) to (35) has been provided to an audit or review client, a threat to independence may still be created by the provision of the non-assurance service. In such circumstances, members and firms are required, in accordance with the provisions of Rule 204.3, to evaluate any threats so created and apply safeguards to reduce them to an acceptable level or decline the audit or review engagement.

55A Members and firms are also required by Rule 204.5(d) to document:

(a) a description of the previously provided non-assurance service;

(b) the results of the discussion with the audit committee;

(c) any further measures applied to address the threat created by the provision of the previous non-assurance service; and

(d) the rationale to support the decision of the member or firm to accept the audit or review engagement.

REPORTING ISSUERS AND LISTED ENTITIES

56 Rule 204.4(35)(b) addresses the situation where A non-assurance service has been provided to an audit client prior to that is not a reporting issuer would not impair the firm's independence when the that client becomesing a reporting issuer or listed entity; and the non-assurance service would have been prohibited by the provisions of Rules 204.4(22) to (34) in relation to the performance of an audit engagement for a reporting issuer or listed entity. provided:

Rule 204.4(35)(b) requires the member or firm to:

(a) discuss independence issues related to the provision of the non-assurance service with the audit committee;

(b) require the client to review and accept responsibility for the results of the non-

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assurance service; and

(c) preclude personnel who provided the non-assurance service from participating in the audit engagement

such that any threat created by the provision of the non-assurance service is reduced to an acceptable level.

~~(a) the previous non-assurance service was not prohibited by Rule 204.4 for an audit client that is not a reporting issuer; and~~

~~(b) the firm had implemented appropriate safeguards to eliminate or reduce to an acceptable level any threats to independence arising from the previous service.~~

56A Members and firms are also required by Rule 204.5(e) to document:

(a) a description of the previously provided non-assurance service;

(b) the results of the discussion with the audit committee;

(c) any further measures applied to address the threat created by the provision of the previous non-assurance service; and

(d) the rationale to support the decision of the member or firm.

57 For the purposes of Rule 204.4 an entity is becomes a reporting issuer by virtue if it is defined as a reporting issuer under the applicable Canadian provincial or territorial securities legislation and has market capitalization or total assets in excess of \$10,000,000. In the case of a period in which an entity makes a public offering, market capitalization is measured at the closing price on the day of the public offering and total assets refers to the total assets presented on the most recent financial statements, prepared in accordance with generally accepted accounting principles, that are included in the offering document. An entity is a listed entity if it has shares, debt or other securities that are quoted on, listed on or marketed through a recognized stock exchange or other equivalent body, whether that recognized stock exchange or other equivalent body is located within or outside of Canada, and has market capitalization or total assets in excess of \$10,000,000. In the case of a period in which an entity makes a public offering, market capitalization is measured at the closing price on the day of the public offering and total assets refers to the total assets presented on the most recent financial statements, prepared in accordance with generally accepted accounting principles, that are included in the offering document. ~~having market capitalization or total assets in excess of \$10,000,000. In the case of a period in which an entity makes a public offering, market capitalization is measured at the closing price on the day of the public offering and total assets refers to the total assets presented on the most recent financial statements, prepared in accordance with generally accepted accounting principles, that are included in the offering document.~~

58 When an entity becomes a reporting issuer or listed entity by virtue of a public offering, the auditor of the entity is required, from that period forward until the entity ceases to be a reporting issuer or listed entity, to comply with the specific prohibitions contained in Rule 204.4 that relate to an audit of a reporting issuer or listed entity. For example, bookkeeping services may not be provided following the date of an initial public offering, except in emergency situations where the market capitalization or total assets of the entity exceed \$10,000,000. The provision of bookkeeping services to the entity prior that date would not impair the firm's independence provided the services were not prohibited by Rule 204.4(23) and provided the firm had complied with the provisions of Rule

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~~204.4(35)(b) implemented appropriate safeguards to eliminate, or reduce to an acceptable level, any threats to independence arising from the provision of the services. Such safeguards might include:~~

- ~~• discussing the matter with the audit committee; or~~
- ~~involving an additional member of the firm who is not, and never was, on the engagement team to advise on the impact of the bookkeeping services provided on the independence of the persons on the engagement team and the firm.~~

APPLICATION OF THE FRAMEWORK

59 The following examples describe the application of the framework to specific circumstances and relationships that may create threats to independence. The examples describe potential threats created and safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level. The examples are not intended to be comprehensive or all-inclusive. In practice, when independence is required, members and firms should assess the implications of all circumstances and relationships and, where required, assess those of network firms, to determine whether there are threats to independence that are other than clearly insignificant and, if they exist, whether safeguards can be applied to satisfactorily address them. In situations where safeguards are not available to reduce a threat or threats to an acceptable level, the only possible actions are to eliminate the activity, interest or relationship creating the threats, or to refuse to accept or continue the assurance engagement.

A. FINANCIAL INTERESTS

60 A financial interest in an assurance client may create a self-interest threat. In evaluating the significance of the threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, it is necessary to examine the nature of the financial interest. This includes an evaluation of the role of the person holding the financial interest, whether that interest is material and whether it is direct or indirect.

61 ~~Financial interests may be held through an intermediary such as a collective investment vehicle, estate or trust. The determination of whether such financial interests are direct or indirect will depend upon whether the beneficial owner has control over the investment vehicle or the ability to influence its investment decisions. When such control or ability exists, that financial interest is a direct financial interest. Conversely, when such control or ability does not exist, such a financial interest is an indirect financial interest. When evaluating whether a financial interest is direct or indirect, consideration should be given to the fact that financial interests range from those where the individual has no control over the investment vehicle or the financial interest held (e.g., a mutual fund or similar intermediary vehicle) to those where the individual has control over the financial interest (e.g., as a trustee) or is able to influence investment decisions of the entity in which the particular financial interest exists. In evaluating the significance of any threat to independence, it is important to consider the degree of control or influence that can be exercised over the intermediary, the financial interest held, or the intermediary's investment strategy. When control exists, the financial interest should be considered direct. Conversely, when control does not exist the financial interest should be considered indirect.~~

62 In the application of Rules 204.4(1) to (12) to an assurance, audit or review client the reference to an assurance, audit or review client, a client or an entity includes related

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entities, as defined, of the assurance, audit or review client, client or entity, as the case may be.

Assurance clients

63 Rule 204.4(1) provides that a member or student who participates on an engagement team for an assurance client, including an audit or review client, and the member's or student's immediate family member may not hold a direct financial interest or a material indirect financial interest in the assurance client.

64 A reasonable observer will not view a member who holds a direct financial interest or material indirect financial interest as a trustee differently than someone who holds the interest beneficially. Accordingly Rule 204.4(1) applies to members, students and immediate family members of members or students who hold a direct financial interest or material indirect financial interest in the capacity of a trustee.

65 When a person on an engagement team, or any of the person's immediate family members, receives, for example, by way of gift or inheritance ~~or as a result of a merger or reorganization~~, a direct financial interest or a material indirect financial interest in an ~~particular~~ assurance client, or a related entity ~~of the client in the case of an assurance client that is an audit or review client~~, one of the following actions should be taken to comply with Rule 204.4(1):

- dispose of the financial interest at the earliest practical date but no later than 30 days after the person has knowledge of the financial interest and the right or ability to dispose of it; or
- remove the person from the engagement team.

During the period prior to disposal of the financial interest or the removal of the person from the engagement team, consideration should be given to whether additional safeguards are necessary to reduce the threat to independence to an acceptable level. Such safeguards might include:

- discussing the matter with the audit committee; or
- involving another member of the firm who is not, and has not been, on the engagement team to review the work done by the person, or advise as necessary.

Members are reminded that Rule 204.~~65~~ requires a member who has an interest that is precluded by this Rule to advise in writing a designated partner of the firm of the interest. When a financial interest in an assurance client or related entity is acquired as a result of a merger or acquisition, the provisions of Rule 204.4(40) apply.

66 When a person on an engagement team knows that a close family member has a direct financial interest or a material indirect financial interest in the ~~particular~~ assurance client, or a related entity ~~of the client in the case of an assurance client that is an audit or review client~~, a self-interest threat may exist. In evaluating the significance of any such threat, consideration should be given to the nature of the relationship between the person on the engagement team and the close family member and the materiality of the financial interest. Once the significance of the threat has been evaluated, safeguards should be applied. Such safeguards might include:

- the close family member disposing of all or a sufficient portion of the financial interest

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at the earliest practical date;

- discussing the matter with the audit committee;
- involving another member of the firm who is not, and never was, on the engagement team to review the work done by the particular person on the engagement team or advise as necessary; or
- removing the person from the engagement team.

67 Consideration should be given to whether a self-interest threat may exist because of the financial interests of individuals other than those on the engagement team and their immediate and close family members. Such individuals would include:

- a member of the firm who provides a non-assurance service to the assurance client;
- a member of the firm who has a close personal relationship with a person on the engagement team;
- a spouse or dependant of an immediate or close family member of a person on the engagement team; and
- an individual for whom a member of the engagement team holds power of attorney.

Whether the interests held by such individuals may create a self-interest threat will depend upon factors such as:

- the firm's organizational, operating and reporting structure;
- the nature of the relationship between the individual and the person on the engagement team; and
- in the case of a power of attorney, the degree of decision making power granted by the power of attorney.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:

- where appropriate, policies to prohibit such individuals from holding such interests;
- discussing the matter with the audit committee; or
- involving another member of the firm who is not, and never was, on the engagement team to review the work done by the particular individual or advise as necessary.

68 ~~Subject to Rule 204.4(7) relating to an audit or review engagement,~~ Ithe specific prohibitions of Rule 204.4 do not preclude a firm from accepting an assurance engagement with an entity if one or more partners of the firm who do not participate on the engagement team, and who do not practice in the same office as the lead engagement partner, have a financial interest in the entity. However, Rule 204.1 requires the firm to be independent in fact and appearance and requires the firm to identify threats to independence arising from such circumstances, evaluate the significance of the threats and, if they are other than clearly insignificant, apply safeguards to reduce the threats to an acceptable level. If adequate safeguards are not available the firm should not accept the engagement.

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- 69 An inadvertent breach of the provisions of Rules 204.4(1) to (12)~~the principles in this Council Interpretation as they relate to a financial interest in an assurance client, or a related entity of the client in the case of an assurance client that is an audit or review client~~, would not impair the independence of the member of the firm or the firm when:
- the firm has established policies and procedures that require a network firm and all members of the firm to report promptly any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;
 - the firm promptly notifies the network firm or the member of the firm that the financial interest should be disposed of; and
 - the disposal occurs at the earliest practical date after identification of the issue, but no later than 30 days after the person has both the knowledge of the financial interest and the right or ability to dispose of it, or the person is removed from the engagement team.

- 70 When an inadvertent breach of the provisions of Rules 204.4(1) to (12)~~principles relating to a financial interest in an assurance client~~ has occurred, the firm should consider whether, and if so which, safeguards should be applied. Such safeguards might include:
- involving another member of the firm who is not, and never was~~has not been~~, on the engagement team to review the work done by the particular member involved in the breach; or
 - excluding the particular person from any substantive decision-making concerning the assurance engagement.

Members are reminded that Rule 204.~~65~~ requires a member who has an interest that is precluded by ~~this~~ Rule 204 to advise in writing a designated partner of the firm of the interest. Inadvertent breaches are also discussed in paragraph 035 of this Council Interpretation.

Assurance clients that are not audit or review clients

71 84 Rule 204.4(2)(a) provides that a firm may not have a direct financial interest or a material indirect financial interest in an assurance client that is not an audit or review client or in a related entity. ~~It also provides that a firm may not have a material financial interest in an entity that has a controlling interest in an assurance client that is not an audit or review client. The rule does not extend to related entities of the client.~~

72 82 With respect to an restricted-use report for an assurance engagement that is not an audit or review engagement, assurance report for an assurance client that is not an audit client or a review client where the report is intended only for the use of identified users, as contemplated by the CICA Handbook – Assurance, members are referred to the provisions in paragraph 28 of this Council Interpretation.

Audit or review clients

734 Rule 204.4(2)(b) provides that a member or firm may not perform an audit or review engagement for an entity if the member, firm or a network firm has a direct financial interest or a material indirect financial interest in the entity or in a related entity. ~~of the~~

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~~entity.~~

- 742** Rule 204.4(3) provides that a member or firm may not perform an audit or review engagement for an entity if a pension or other retirement plan of the firm or a network firm has a direct financial interest or a material indirect financial interest in the entity or in a related entity ~~of the entity.~~
- 753** Rule 204.4(4) provides that a partner of a firm who holds, or whose immediate family member, except in specified circumstances, holds, a direct financial interest or a material indirect financial interest in an audit or review client of the firm, or a related entity of the client, may not practice in the same office as the lead engagement partner for the client.
- 764** The office in which the lead engagement partner practices in connection with an audit or review engagement is not necessarily the office to which that partner is ordinarily assigned. Accordingly, for the purposes of Rule 204.4(4) and this Council Interpretation, when the lead engagement partner is located in a different office from others on the engagement team, professional judgment should be exercised to determine in which office the partner practices in connection with the audit or review engagement.
- 775** Rule 204.4(5) provides that a partner or managerial employee of a firm who holds, or whose immediate family member, except in specified circumstances, holds, a direct financial interest or a material indirect financial interest in an audit or review client of the firm, or in a related entity of the client, may not provide a non-assurance service to the client, unless the non-assurance service is clearly insignificant.
- 786** ~~Subject to Rule 204.4(7),~~ A financial interest in an audit or review client, or a related entity ~~of the client~~, that is held by an immediate family member of:
- a partner located in the office in which the lead engagement partner practices in connection with the audit or review engagement; or
 - a member of the firm who provides a non-assurance service to the client;
- would not create an unacceptable threat to independence provided the financial interest is received as a result of the immediate family member's employment ~~rights~~ (e.g., pension rights or share options), the immediate family member does not have the right to dispose of the financial interest or, in the case of a share option, the right to exercise the option and, where appropriate, safeguards are applied to reduce any threat to independence to an acceptable level.
- 797** A self-interest threat may exist if the firm, or the network firm, or a person on the engagement team has a financial interest in a particular entity, and an audit or review client or a director, officer or controlling owner thereof also has a financial interest in that entity. Independence is not impaired with respect to the audit or review client if the respective financial interests of the firm, the network firm, or person on the engagement team, and the client or director, officer or controlling owner thereof are immaterial and the client cannot exercise significant influence over the entity.
- 8078** Rule 204.4(6) provides that a member or firm may not perform an audit or review engagement for a client if the firm or a network firm has a financial interest in another entity, and the member or firm knows that the client or a director, officer or controlling

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owner of the client also has a financial interest in the other entity, unless the respective financial interests referred to are immaterial and the client cannot exercise significant influence over the other entity. In addition, a member or student may not participate on the engagement team for an audit or review client if that person or that person's immediate family member has a financial interest in another entity and knows that the client or a director, officer or controlling owner of the client also has a financial interest in the entity, unless the respective financial interests referred to are immaterial and the client cannot exercise significant influence over the entity.

8179 *Intentionally left blank.* ~~Rule 204.4(7) provides that a member or a firm may not perform an audit or review engagement for an entity if a partner or a professional employee of the firm owns, or such person's immediate family owns, more than 0.1% of the securities of the entity or controls the entity by means other than the ownership of the majority of the entity's common shares. The rule further provides that such interest may not be held in a related entity of the entity.~~

8280 *Intentionally left blank.* ~~Rule 204.4(8) provides that a member or student may not participate on the engagement team of an audit or review client if such person knows that his or her close family owns more than 0.1% of the securities of the client, or a related entity of the client, or controls the client, or related entity of the client, by means other than the ownership of the majority of the entity's common shares. Rule 204.4(8) only applies when the person has knowledge of the securities held by his or her close family member. The rule does not put an onus on the person to determine which, if any, securities his or her close family members hold.~~

B. LOANS AND GUARANTEES

83 Rule 204.4(10) provides that a firm may not have a loan from₁ or have a loan guaranteed by₁ an assurance client except where the client is a bank or similar financial institution and the loan or guarantee is immaterial to the firm and the client₁ and the loan or guarantee is made under normal commercial terms and conditions and is in good standing. The rule further provides that a firm may not make a loan to an assurance client that is not a bank or similar financial institution nor guarantee a loan of an assurance client.

84 Rule 204.4(11) provides that a firm may not accept a loan from, or have a loan guaranteed by₂ an officer or director of an assurance client₇, or a shareholder of the client who owns more than 10% its equity securities, unless the shareholder is a bank or similar financial institution and the loan or guarantee is made under normal commercial terms and conditions. In addition, a firm may shall not make a loan to, or guarantee a loan of, such a person.

85 Rule 204.4(12) provides that a member or student may not participate on the engagement team for an assurance client of the firm if:

- (a) the member or student accepts a loan from, or has a loan guaranteed by, the client, unless the client is a bank or similar financial institution and the loan or guarantee is made under normal commercial terms and conditions and the loan is in good standing;
- (b) the member or student accepts a loan from, or has a loan guaranteed by, an officer

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- or director of the client, or a shareholder of the client who owns more than 10% of its equity securities, unless the shareholder is a bank or similar financial institution and the loan or guarantee is made under normal commercial terms and conditions; or
- (c) the member or student has made a loan to, or guaranteed the borrowings of the client that is not a bank or similar financial institution, an officer or director of the client, or a shareholder of the client who owns more than 10% its equity securities.
- 86** A loan from, or a loan guaranteed by, ~~from~~ an assurance client that is a bank or a similar financial institution to a person on the engagement team or his or her immediate family member would not create a threat to independence provided the loan or guarantee is made under normal commercial terms and conditions and is in good standing. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.
- 87** Similarly, deposits or brokerage accounts of a firm or a person on the engagement team with an assurance client that is a bank, broker or similar financial institution would not create a threat to independence provided the deposit or brokerage account was held under normal commercial terms and conditions.
- 88** Rules 204.4(10) and (11) relate to loans and guarantees between a firm and an assurance client. In the case of an assurance client that is an audit or review client, the provisions of Rules 204.4(10) and (11) also apply to network firms. ~~In the case of an assurance client that is an audit or review client~~ In all cases the provisions of Rule 204.4(10), (11) and (12) should be read as applying also to related entities of the client.

C. CLOSE BUSINESS RELATIONSHIPS

- 89** A close business relationship between a firm, a network firm or a person on the engagement team and the assurance client or its management, involving a common commercial or financial interest may create a self-interest or an intimidation threat. Members and firms should also consider whether such threats may be created by close business relationships with a related entity or its management. The following are examples of such relationships:
- (a) having a material financial interest in a joint venture with the client or a controlling owner, director, officer or other individual who performs senior management functions for that client;
 - (b) arrangements to combine one or more services or products of the firm with one or more services or products of the client and to market the package with reference to both parties; and
 - (c) arrangements under which either the firm or the client acts as a distributor or marketer of the other's products or services.
- A close business relationship does not include the relationship created by the professional engagement between the client and the member, the firm, or the network firm as the case may be.
- 90** Rule 204.4(13) provides that a firm or a network firm may not have a close business relationship with an audit or review client or its management unless that relationship is limited to a financial interest that is immaterial and the relationship is clearly insignificant

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to the firm or network firm and the client or its management. In the case of an assurance client that is not an audit or review client, a firm may not have a close business relationship with the client or its management unless that relationship is limited to a financial interest that is immaterial and the relationship is clearly insignificant to the firm and the client or its management, as the case may be.

- 91 Rule 204.4(13) also provides that a member or student who, or whose immediate family member, has a close business relationship with an assurance client (whether audit, review or other) or its management may not be on the engagement team for the client unless that relationship is limited to a financial interest that is immaterial and the relationship is clearly insignificant to the member or student and the client or its management.
- 92 In the case of an audit or review client, a business relationship involving an interest held by a firm, a network firm or a person on the engagement team or any of that person's immediate family members in a closely held entity in which the client or a director or officer of the client, or any group thereof, also has an interest, does not create threats to independence provided:
- the relationship is clearly insignificant to the firm, the network firm and the client;
 - the interest held is immaterial to the investor, or group of investors; and
 - the interest does not give the investor, or group of investors, the ability to control the closely held entity.
- 93 The purchase of goods or services from an assurance client by a firm (and, in the case of an audit client, by a network firm) or a person on the engagement team will not generally create a threat to independence, provided the transaction is conducted in the normal course of the client's business and on an arm's length basis. However, such a transaction may be of a nature or magnitude such that it does create a self-interest threat. If the threat so created is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:
- reducing the magnitude of or eliminating the transaction;
 - removing the individual involved from the engagement team; or
 - discussing the issue with the audit committee.

D. FAMILY AND PERSONAL RELATIONSHIPS

- 94 Family and personal relationships between a person on an engagement team and a director, officer or certain employees, depending on their role, of the assurance client or a related entity may create a self-interest, familiarity or intimidation threat. The significance of such a relationship will depend on a number of factors, including the person's responsibilities on the assurance engagement, the closeness of the relationship and the role of the family member or other individual within the assurance client or related entity. Consequently, there are many circumstances that involve a threat to independence that will require evaluation.

- 94A A person has an accounting role when the person is in a position to or does exercise more than minimal influence over the contents of the client's accounting records related

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to the financial statements that are subject to audit or review by the member or firm or over anyone who prepares such financial statements.

94B A person has a financial reporting oversight role when the person is in a position to or does exercise influence over the financial statements that are subject to audit or review by the member or firm or over anyone who prepares such accounting records or financial statements.

105^{part} An individual holding one of the following titles will generally be considered to be in a financial reporting oversight role: a member of the board of directors or similar management or governing body, president, chief executive officer, chief operating officer, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, and, depending upon the particular facts and circumstances, the general counsel.

106 ~~The term “financial reporting oversight role” means a position in which a person may or does exercise influence over either the contents of the financial statements or anyone who prepares them.~~ When the financial statements of an audit or review client the reporting issuer are consolidated, a financial reporting oversight role can extend beyond to the client reporting issuer and to its subsidiaries or investees. In determining whether an individual is in a financial reporting oversight role for the audit or review client, reporting issuer, consideration should be given to the position of the individual, the extent of the individual’s involvement in the financial reporting process of the client reporting issuer and the impact of the individual’s role on the financial statements subject to audit or review by the member or firm of the consolidated financial statements of the reporting issuer.

95 Rule 204.4(14) provides that a member or ~~a~~ student may not participate on the engagement team for an assurance client if such person’s immediate family member is an officer or director or officer of the client or a related entity or is an employee of the client in a position to exert ~~direct and~~ significant influence over the subject matter of the engagement, or was in such a position during any period covered by the assurance report or the engagement period.

96 When a close family member of a person on the engagement team is an officer or director, an officer or an employee of the assurance client or is in a position to exert ~~direct and~~ significant influence over the subject matter of the assurance engagement, a threat to independence may be created. The significance of the threat will depend on factors such as:

- the position the close family member holds ~~with the client~~; and
- the role of the particular person on the engagement team.

The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:

- removing the particular person from the engagement team;
- where possible, restructuring the engagement team’s responsibilities so that the particular person does not deal with matters that are within the responsibility of the

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close family member; or

- policies and procedures to empower staff to communicate, without fear of retribution, to senior levels within the firm any issue of independence and objectivity that may concern them.

- 97 A self-interest, familiarity or intimidation threat may exist when:
- (a) an officer or director, officer or person in a position to exert significant influence over the subject matter of the assurance engagement, employee of an assurance client who is not an immediate or close family member of a person on the engagement team, has a close relationship with a person on the engagement team; or and is in a position to exert direct and significant influence over the subject matter of the assurance engagement
- (b) a director, officer or employee in a financial reporting oversight role with respect to an audit or review client, who is not an immediate or close family member of a person on the engagement team, has a close relationship with a person on the engagement team.

Those on the engagement team should identify such individuals, and evaluate the relationship and consult with others in the firm in accordance with its policies and procedures. The evaluation of the significance of any ~~such~~ threat and the availability of safeguards appropriate to eliminate it or reduce it to an acceptable level will include considering matters such as the closeness of the relationship and the role of the individual ~~within the client~~.

- 98 Consideration should be given to whether a self-interest, familiarity or intimidation threat exists because of a personal or family relationship between a member of the firm who is not part of the engagement team and:
- (a) an officer or director of the assurance client or a related entity, or person officer or employee of the assurance client who is in a position to exert direct and significant influence over the subject matter of the assurance engagement; or
- (b) an officer or director of the assurance client or a related entity, or person in a financial reporting oversight role with respect to the financial statements subject to audit or review by the member or firm.

Members of the firm should identify and evaluate the relationship and consult with others in the firm in accordance with its policies and procedures. The evaluation of the significance of any threat and the availability of safeguards appropriate to eliminate it or reduce it to an acceptable level will include considering matters such as the closeness of the relationship, the interaction of the member of the firm with the engagement team, the position held within the firm, and the role of the individual ~~within the client~~.

- 99 An inadvertent breach of the provisions of Rules 204.4(14) or (15) the principles in this Council Interpretation as they relate to family and personal relationships would not impair the independence of ~~a the~~ member of the firm, or ~~a the~~ firm, when:
- the firm has established policies and procedures that require all members of the firm to report promptly to the firm any breaches resulting from changes in the employment status of their immediate or close family members or other personal relationships that create a threat to independence;
 - either the responsibilities of the engagement team are restructured so that the

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person on the engagement team does not deal with matters that are within the responsibility of the person with whom he or she is related or has a personal relationship, or, if that is not possible, the firm promptly removes that person from the engagement team; and

- additional care is given to reviewing the work of the particular person on the engagement team.

100 When an inadvertent breach of the provisions of Rules 204.4(14) or (15) ~~the principles in this Council Interpretation~~ relating to family and personal relationships has occurred, the firm should consider whether, and if so which, safeguards should be applied. Such safeguards might include:

- involving another member of the firm who is not, and never was, on the engagement team to review the work done by the person on the engagement team; or
- excluding that person from any substantive decision-making concerning the assurance engagement.

Members are reminded that Rule 204.~~65~~ requires a member who has a relationship that is precluded by this Rule to advise in writing a designated partner of the firm of the interest. Inadvertent breaches are also discussed in paragraph ~~035~~ of this Council Interpretation.

Audit clients that are reporting issuers or listed entities

101 Rule 204.4(15) provides that a member or ~~a~~ student may not participate on the engagement team for an audit client that is a reporting issuer or listed entity if such person's immediate or close family member has is in an accounting role or a financial reporting oversight role ~~at the client~~, or had was in such a position during the any period covered by the financial statements subject to audit by the member or firm or the engagement period.

E. EMPLOYMENT WITH AN ASSURANCE CLIENT

General provisions

102 The independence of a firm or a person on the engagement team may be threatened if an officer or director, ~~officer or employee~~ of the assurance client or a related entity, or a person in a position to exert influence over the subject matter of the assurance engagement has been a member of or ~~on~~ the engagement team or a partner of the firm. Such circumstances may create a self-interest, familiarity or intimidation threat, particularly when a significant connection remains between the individual and his or her former firm.

103 The significance of a threat so created will depend upon the following factors:

- the position the individual has taken at the client and whether the position involves direct or significant influence over the subject matter of the assurance engagement or the financial statements subject to audit or review by the member or firm;
- the amount of any involvement the individual will have with the engagement team;
- the length of time since the individual was on the engagement team or with the firm; and

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- the former position of the individual within the engagement team or firm.

The significance of such a threat should be evaluated and, if it is other than clearly insignificant, available safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- ~~considering the appropriateness or necessity of~~ modifying the plan for the assurance engagement;
- assigning an engagement team to the subsequent assurance engagement that is of sufficient seniority and experience in relation to the individual who has joined the assurance client;
- involving another member of the firm who is not, and never was, on the engagement team to review the work done or advise as necessary; or
- performing an additional quality control review of the assurance engagement by the firm.

In such cases, all of the following safeguards will be necessary to reduce the threat to an acceptable level:

- the particular individual is not entitled to any benefits or payments from the firm unless these are made in accordance with fixed predetermined arrangements. In addition, any amount owed to the individual should not be of such significance to threaten the firm's independence; and
- the particular individual does not continue to participate or appear to participate in the firm's business or professional activities.

104 A self-interest threat exists when a person on the engagement team participates in the assurance engagement while knowing, or having reason to believe, that he or she will or may join the client. In all such cases the following safeguards should be applied:

- having firm policies and procedures that require those on the engagement team to notify the firm when entering employment negotiations with the assurance client; and
- removing the person from the engagement team.

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

The effect of the safeguards described above is that members and students who initiate or entertain discussions with respect to a potential role with an assurance client would be precluded from being on the engagement team for that assurance engagement until such discussions have been concluded and acceptance of such a role has been declined.

Audit clients that are reporting issuers **or listed entities**

105 Notwithstanding the general guidance in paragraphs 0402 to 0404 of this Council Interpretation, Rule 204.4(16)(a) provides that a firm may not perform an audit engagement for a client that is a reporting issuer or listed entity if a person who participated in an audit capacity in an audit of the financial statements of the client is an officer or director of the client or a related entity or ~~is employed~~ in a financial reporting

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oversight role ~~for the client within unless~~ a period of one year ~~has elapsed from after~~ the date when the financial statements of the client were filed with the relevant securities regulator or stock exchange. ~~An individual holding one of the following titles will generally be considered to be in a financial reporting oversight role: a member of the board of directors or similar management or governing body, president, chief executive officer, chief operating officer, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, and, depending upon the particular facts and circumstances, the general counsel.~~

106 Rule 204.4(16)(b) provides that, where a person who was the firm's chief executive officer is an officer or director of the client or related entity or is in a financial reporting oversight role, a firm may not perform an audit engagement for the client unless a period of one year has elapsed from the date that the person assumed that position. Chief executive officer means a person in a position having the usual responsibility and authority of a chief executive officer regardless of the title applied to the person.

107 For the purposes of Rule 204.4(16)(a), other than a key audit partner, ~~the lead engagement partner and the engagement quality control reviewer~~, the following persons are not considered to have participated in an audit capacity in an earlier audit.:

- (a) a person who is employed by the reporting issuer or listed entity due to an emergency or other unusual situation provided that the entity's audit committee has determined that the employment of such person is in the interest of the shareholders;
- (b) a person who ~~has~~ provided ten or fewer hours of assurance services in the earlier audit;
- (c) a person who recommended the compensation of, or who provided direct supervisory, management or oversight of, the lead engagement partner in connection with the performance of the earlier audit, including those at all successively senior levels above the lead engagement partner through to the firm's chief executive; and
- (d) a person who provided quality control for the audit engagement.

108 An individual may have fully complied with Rule 204.4(16)(a) and (b) in accepting employment with an entity, and subsequently thereto, the entity merged with or was acquired by another entity resulting in that individual having a financial reporting oversight role of a combined entity which is audited by the firm in which the individual was previously an employee or a partner. In such a circumstance, unless the employment offer was accepted in contemplation of the merger or acquisition, the individual or the entity could not be expected to know that the employment decision could result in a threat to independence. In all such cases the safeguard of informing the audit committee should be applied.

109 For the purposes of Rule 204.4(16)(a) audit procedures are deemed to have commenced for the current audit engagement period on the day after the financial statements for the previous period are filed with the relevant securities regulator or stock exchange.

F. RECENT SERVICE WITH AN ASSURANCE CLIENT

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- 110 A self-interest, self-review or familiarity threat may exist when a former officer ~~or~~, director ~~or employee~~ of an assurance client or related entity or a person who has been in a financial reporting oversight role becomes a part of the engagement team for that assurance client.
- 111 Rule 204.4(17)(a) provides that a member or ~~a~~ student may not participate on the engagement team for an assurance client if such person served as an officer or director of the client or had been ~~an employee thereof~~ in a position to exert ~~direct and~~ significant influence over the subject matter of the engagement during the period covered by the assurance report or the engagement period.
- 111A2 If, prior to the period covered by an assurance report, a person on the engagement team served as an officer or director on the board of directors of the assurance client or a related entity, or had been ~~an employee~~ in a position to exert ~~direct and~~ significant influence over the subject matter of the assurance engagement, a self-interest, self-review or familiarity threat may exist. For example, such a threat will exist if a decision made or work performed by that individual in the prior period, while employed by the client, is to be evaluated in the current period as part of the assurance engagement. The significance of the threat will depend upon factors such as:
- the position the individual held ~~with the client~~;
 - the length of time since the individual left the position; and
 - the role of the individual on the engagement team.
- The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:
- involving another member of the firm who is not, and never was, on the engagement team to review the work of the particular person or advise as necessary; or
 - discussing the issue with the audit committee.
- 112 Rule 204.4(17)(b) provides that, except in specific circumstances, a member or firm may not perform an audit or review engagement for an entity if, during either the period covered by the financial statements subject to audit or review by the member or firm or the engagement period, the member or firm has loaned a member of the firm or a network firm to the entity or a related entity.

G. SERVING AS AN OFFICER OR A MEMBER OF THE BOARD OF DIRECTORS OF AN ASSURANCE CLIENT

- 113 Rule 204.4(18)(a) provides that a member or employee of a firm may not serve as an officer or director ~~of for~~ an assurance client or a related entity. In the case of an audit or review client that is not a reporting issuer or listed entity, this prohibition is extended to ~~related entities of the client and~~ members and employees of network firms by Rule 204.4(18)(b9). However, a partner or employee of the firm or a network firm may serve as company secretary for an assurance audit or review client that is not a reporting issuer or listed entity where permitted by local law, professional rules or practice, and when the duties and functions undertaken are limited to those of a routine and formal administrative nature. In the case of an audit client that is a reporting issuer or listed entity, Rule 204.4(19) provides that a member or employee of a firm or a network firm may not serve as an officer or director of the reporting issuer or listed entity client or a

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related entity. The exception for serving as company secretary, where permitted by local law, professional rules or practice, and when the duties and functions undertaken are limited to those of a routine and formal administrative nature, is not extended to include such audit engagements.

Company secretary

- 114 The position of company secretary has different implications in different jurisdictions. The duties of company secretary may range from administrative duties such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally this position is seen to imply a close degree of association with the entity and may create self-review and advocacy threats.
- 115 If a partner or employee of a ~~network~~ firm serves as company secretary for an assurance audit or review client or related entity, the self-review and advocacy threats created would generally be so significant that safeguards are unlikely to be available to reduce the threats to an acceptable level. Similarly, if a partner or employee of a firm or network firm serves as company secretary for an audit or review client that is not reporting issuer or listed entity or a related entity, the self-review and advocacy threats created would generally be so significant that safeguards are unlikely to be available to reduce the threats to an acceptable level. However, when the practice of acting as company secretary is specifically permitted under local law, professional rules or practice, the duties and functions undertaken should be limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns.
- 116 Routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters is generally not perceived to impair independence, provided client management makes all relevant decisions.

H. RELIGIOUS ORGANIZATIONS

- 117 A threat to independence is ordinarily not created when a person on the engagement team, or any of the person's immediate or close family members, belongs to a religious organization that is an assurance client provided the person on the engagement team, or the immediate or close family member:
- (a) does not serve on the religious organization's governing body; and
 - (b) does not have the right or responsibility to exercise significant influence over the financial or accounting policies of the religious organization or any of its associates.

I. Intentionally left blank ~~SOCIAL CLUBS~~

- 118 ~~Intentionally left blank. Notwithstanding Rules 204.1 to 204.4, a threat to independence is ordinarily not created when a person on the engagement team, or an immediate or close family member of the engagement team, holds qualifying shares in a social club, such as a golf club, curling club, co-operative or similar organization, where the shareholding is a prerequisite of club membership, provided:~~
- ~~(a) the assets of the organization cannot by virtue of the organization's by-laws be~~

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~~distributed to the individual club members other than in circumstances of forced liquidation or expropriation, unless there is a written undertaking with the organization to forfeit entitlement to such distributed assets;~~

~~(b) neither the person on the engagement team nor the immediate or close family member:~~

~~(i) serves on the governing body or as an officer of the organization;~~

~~(ii) has the right or responsibility to exercise significant influence over the financial or accounting policies of the organization or any of its associates; or~~

~~(iii) exercises any right derived from membership to vote at meetings of the organization; and~~

~~(c) the club member cannot dispose of the membership for gain.~~

J. LONG ASSOCIATION OF SENIOR PERSONNEL WITH AN ASSURANCE CLIENT

119 The use of the same senior personnel on the engagement team on an assurance engagement over a long period of time may create a familiarity threat. The significance of such a threat will depend upon factors such as:

- the length of time that the particular individual has been on the engagement team;
- the role of that individual on the engagement team;
- the structure of the firm; and
- the nature of the assurance engagement including the complexity of the subject matter and degree of professional judgment needed.

The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- discussing the matter with the audit committee;
- replacing the senior personnel on the engagement team;
- involving an additional member of the firm who is not, and never was, on the engagement team to review the work done by the particular individual, or advise as necessary;
- the member or firm is subject to external practice inspection; or
- an independent internal quality review of the assurance work performed by a member of the firm who was not part of the engagement team.

Audit clients that are reporting issuers or listed entities

120 Rule 204.4(20)(a) provides that a member may not continue as the lead engagement partner, or the engagement quality control reviewer, with respect to the audit of the financial statements of for an audit client that is a reporting issuer or listed entity for more than seven years in total and may shall not thereafter participate in an audit of the financial statements of the entity resume or assume either such role until a further five years have elapsed since the member ceased to be the lead engagement partner or the engagement quality control reviewer.

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- 120A** Rule 204.4(20)(b) provides that a member, ~~who is a key audit partner~~ other than a the lead engagement partner or the engagement quality control reviewer, on the engagement team, providing, during the engagement period, more than ten hours of assurance services in connection with the annual financial statements or interim financial information of the reporting issuer or is a subsidiary engagement partner ~~may not provide such services~~ may not continue as a key audit partner on the engagement team with respect to the audit of the financial statements of a reporting issuer or listed entity for a period of more than seven years in total and may shall not thereafter participate in an audit of the financial statements of the entity resume providing such services until a further two years have elapsed. ~~since the member ceased to provide such services.~~
- 120B** In the case of a reporting issuer that is a mutual fund Rules 204.4(20(a)(ii) and (b)(ii) extend the partner rotation requirements and restrictions described above to the audits of financial statements of mutual funds that are reporting issuers within the same mutual fund complex, as defined.
- 120C** ~~The provisions in Rule 204.4(20)(b) do not apply to those “specialty” and “technical” partners who consult with others on the engagement team regarding technical or industry-specific issues, transactions or events, including taxation matters. In addition, the provisions do not apply to those partners who, subsequent to the issuance of the audit report, provide quality control for the engagement. Such partners typically have a low level of involvement with senior management as well as a relatively low level responsibility for overall presentation in the financial statements.~~
- 121** ~~*Intentionally left blank.*~~ Rule 204.4(20) provides that an audit partner who has completed the permitted term as a lead engagement partner, engagement quality control reviewer or other key audit partner may not participate in the audit until further prescribed time periods have elapsed. Accordingly, such partners may not:
- provide services pertaining directly to the audit or to a review of interim financial statements;
 - provide quality control for either such engagement;
 - consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events; or
 - otherwise directly influence the outcome of any such engagement.
- However, such partners may be consulted for the purpose of transferring knowledge of the client to the engagement team.
- 122** When an audit client becomes ~~a reporting issuer~~ or listed entity, the length of time ~~the a key audit lead engagement~~ partner has served in that capacity should be considered in determining when the partner must be replaced on the engagement team. However, Rule 204.4(20)(c) provides that if the a key audit lead engagement partner has served in that capacity for five or more ~~fiscal~~ years at the time the client becomes a reporting issuer or listed entity, such person may continue in that capacity for two more ~~fiscal~~ years. ~~before being replaced as lead engagement partner.~~
- K. AUDIT COMMITTEE PRIOR APPROVAL OF SERVICES TO A REPORTING ISSUER OR LISTED ENTITY AUDIT CLIENT**
- 123** Rule 204.4(21) provides that a member or firm may not provide a service to a reporting

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issuer or listed entity, that is an audit client, or to a subsidiary thereof, unless the audit committee of the client pre-approves such service. The requirement applies to all audit and non-audit services. For the purpose of Rule 204.4(21) the audit committee recommendation to the entity's board of directors that the particular audit firm be the entity's auditor will be considered to be the approval of the audit service. Subject to paragraph 125, all non-audit services for the reporting issuer or listed entity and its subsidiaries must be specifically pre-approved by the audit committee.

124 The audit committee may establish policies and procedures for pre-approval provided that they are detailed as to the particular services and designed to safeguard the independence of the member and the firm. For example, one or more audit committee members who are independent board directors may pre-approve the service provided decisions made by the designated audit committee members are reported to the full audit committee.

125 Notwithstanding Rule 204.4(21), audit committee pre-approval of services other than assurance services provided to an audit client that is a reporting issuer or listed entity, or to a subsidiary of the client, is not required where all such services that have not been pre-approved:

- (a) do not represent more than five per cent of total revenues paid by the audit client to the member, the firm and network firms in the fiscal year in which the services are provided;
- (b) were not recognized as non-audit services at the time of the engagement; and
- (c) are promptly brought to the attention of the audit committee and the audit committee or one or more designated representatives approves the services prior to the completion of the audit.

126 For the purposes of Rule 204.4(21) audit services include all those services performed to discharge responsibilities to provide an opinion on the financial statements of the reporting issuer or listed entity. For example, in connection with some audit engagements, a tax partner may be involved in reviewing the tax accrual of the client. Since it is a necessary part of the audit process, the activity constitutes an audit service. Similarly, complex accounting issues may require consultation with a national office technical partner to reach an audit judgment. That consultation, being a necessary part of the audit process, also constitutes an audit service, and as such will be considered to have been pre-approved by the audit committee whether or not the firm charges separately for it. These examples contrast with a situation where a client is evaluating a proposed transaction and requests the member, the firm or a network firm to evaluate it and, after research and consultation, the member, firm or network firm provides an answer to the client and bills for those services. Such services would not be considered to be audit services and, therefore, will not be considered to have been pre-approved with the audit service.

L. PROVISION OF NON-ASSURANCE SERVICES TO AN ASSURANCE CLIENT

General provisions

127 Firms have traditionally provided to their ~~assurance~~ clients a range of ~~other non-~~ assurance services that are consistent with their skills and expertise. The provision of

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~~such a non-assurance a-service is not subject to the requirements of not referred to in Rule 204.1 and, accordingly, does not require independence on the part of a member or firm. may, However, the provision of such a non-assurance service may create a self-interest, self-review or advocacy threat that impacts to the independence of the member or firm with respect to the provision of an assurance or specified auditing procedures service for which independence is required by Rule 204.1. Consequently, before a firm accepts an engagement to provide a non-assurance service to an assurance client, it should evaluate the significance of any threat to independence, in relation to an existing assurance service, that may be created by providing the non-assurance service created by providing the service.~~ When such a threat is other than clearly insignificant, the non-assurance engagement should be declined unless appropriate safeguards can be applied to eliminate the threat or threats or reduce them to an acceptable level. Specific circumstances in which adequate safeguards do not exist to eliminate or reduce such a threat to independence to an acceptable level are set out in Rules 204.4(22) to (34) as prohibitions.

128 Subject to the any specific prohibitions set out in Rules 204.4(22) to (34) in these rules to the contrary, a firm or a member of a firm may provide a non-assurance service to an assurance client or related entity, provided that any threats to independence have been reduced to an acceptable level by safeguards, such as:

- policies and procedures to prohibit members of the firm from making management decisions for the client, or assuming responsibility for such decisions;
- discussing independence issues related to the provision of non-assurance services with the audit committee;
- policies within the assurance client regarding the oversight responsibility for provision of non-assurance services by the firm;
- involving another member of the firm who is not on the engagement team to advise on any impact of the non-assurance service engagement on the independence of the persons on the engagement team and the firm;
- involving a professional accountant -colleague from outside of the firm to provide assurance on a discrete aspect of the assurance engagement;
- obtaining the client's acknowledgement of responsibility for the results of the non-assurance service work performed by the firm;
- disclosing to the audit committee the nature of the non-assurance service engagement and extent of fees charged; or
- arranging that the members of the firm providing the non-assurance service do not participate on the assurance engagement team.

129 Intentionally left blank. ~~Notwithstanding the foregoing, the provision of certain non-assurance services to an audit or review client may create a threat to independence so significant that no safeguard will eliminate the threat or reduce it to an acceptable level. However, the provision of such a service to a related entity or division or the provision of a service that relates to a discrete financial statement item of the audit client may be permissible if all threats to the firm's independence have been reduced to an acceptable level by:~~

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~~arranging for that related entity, division or discrete financial statement item to be audited by another firm that is not a network firm; or~~

~~arranging for another firm that is not a network firm to re-perform the non-assurance service.~~

Performance of management functions

130 Rule 204.4(22) provides that, during the period covered by the assurance report or the engagement period, a member of a firm may not make management decisions or perform management functions for an assurance client that is not an audit or review client or related entity unless the management decision or management function is not related to the subject matter of the assurance engagement that is performed by the member or firm. ~~The Rule 204.4(22)(b) further provides that in the case of an audit or review client a member of the firm or a network firm may shall not make any management decisions or perform any management functions for the client or a related entity during either the engagement period or the period covered by the financial statements subject to audit or review by the member or firm. Rule 204.4(22) also provides that in the case of an audit client that is a reporting issuer, a member of the firm or a network firm shall not make management decisions or perform management functions for a related entity of the client.~~ Activities that would constitute a management decision or function include:

- (a) authorizing, approving, executing or consummating a transaction;
- (b) having or exercising authority on behalf of the client;
- (c) determining which recommendation of the member or ~~the~~ firm should be implemented; or
- (d) reporting in a management role to those charged with governance of the client or related entity.

131 ~~Notwithstanding Rule 204.4(22) the independence of a member or a firm would not be impaired by the provision of services to assess the effectiveness of the internal control of an assurance client and to recommend improvements in the design and implementation of internal control and risk management control.~~ Obtaining an understanding of the client's internal controls is required by generally accepted auditing standards. Members often become involved in diagnosing, assessing and recommending to management ways in which internal controls can be improved or strengthened. Notwithstanding Rule 204.4(22) the independence of a member or firm would not be impaired by the provision of services to assess the effectiveness of the internal controls of an assurance client or a related entity and to recommend improvements in the design and implementation of internal controls and risk management control

132 Intentionally left blank. ~~The lending of staff by a firm or network firm to an audit or review client may create a self-review threat when a person so loaned is in a position to influence the preparation of the client's financial statements. In practice, such assistance may be given but only on the understanding that client approval is obtained from the client or related entity for the results of the service and that the person on loan will not be involved in:~~

- ~~making management decisions for the client or related entity;~~
- ~~approving or signing agreements or other similar client documents; or~~

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~~exercising discretionary authority to commit the client or related entity. In such situations the circumstances should be carefully analyzed to identify any threat to independence created and to determine whether additional safeguards should be applied to reduce the threat to an acceptable level.~~

Rebuttable presumption – not subject to audit procedures ~~Audit clients that are reporting issuers~~

- 133 Rules 204.4(24) to (28) set out non-audit services that may not be provided during either the period covered by the financial statements subject to audit or during the engagement period to an audit client that is a reporting issuer or listed entity unless it is reasonable to conclude that the results of any such service will not be subject to audit procedures during the audit of the client's financial statements. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of such services will be subject to audit procedures. Materiality is not an appropriate basis upon which to overcome this presumption. For example, determining whether a subsidiary, division or other unit of the consolidated entity is material is a matter of audit judgment. Therefore, the determination of whether to apply detailed audit procedures to a unit of a consolidated entity is, in itself, an audit procedure.

Preparation of accounting records and financial statements

General provisions

- 134 It is the responsibility of management to ensure that accounting records are kept and financial statements are prepared, although in discharging its responsibility management may request a member or firm to provide assistance.
- 135 Assisting an audit or review client or a related entity in matters such as preparing accounting records or financial statements will create a self-review threat when the financial statements are subsequently audited or reviewed by the member or firm. The significance of any such threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level.
- 136 Rule 204.4(23) provides that a member, or a member of a firm or network firm, may not perform any of the following activities ~~for an entity, including a reporting issuer, that is an audit or review client~~:
- (a) preparing, or changing a journal entry, determining or changing an account code, or a classification for a transaction or preparing or changing another accounting record for the entity or a related entity, that affects the financial statements subject to audit or review by the member or firm without obtaining the approval of management of the entity; and
 - (b) preparing or changing a source document or originating data in respect of any transaction underlying the financial statements subject to audit or review by the member or firm, undertaken or entered into by the entity.

Whether or not the approval of the management of the entity is obtained, it is not permissible for a member of the firm or a network firm to prepare a source document or originating data, or to make a change to such a document or data, that affects the financial statements subject to audit or review by the member or firm.

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- 137** A source document is an initial recording or original evidence of a transaction. Examples of source documents are purchase orders, payroll time cards, customer orders, invoices, disbursement approvals, signed cheques and written contracts. Source documents are often followed by the creation of additional records and reports, such as trial balances, account reconciliations and aged account receivable listings, which do not constitute source documents or initial recordings. Source documents may also be preceded by documents containing calculations and advice, such as bonus calculations for tax purposes, ceiling test calculations in the oil and gas industry and sample wording for clauses in a contract that will be prepared by the client's lawyers. The creation of such additional records, reports and documents would not constitute the creation of source documents.
- 138** Notwithstanding Rules 204.4(23) and (24), the financial statement audit and review process involves extensive dialogue between persons on the engagement team and management of the audit or review client. During this process, management will often request and receive input regarding such matters as accounting principles and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. The provision of technical assistance of this nature for an audit or review client is an appropriate method of promoting the fair presentation of the financial statements. The provision of such advice, *per se*, does not generally threaten the member's or the firm's independence. Other services that are usually a part of the audit or review process and that do not, under normal circumstances, threaten independence include:
- assisting ~~a client with~~ in-resolving account reconciliation problems;
 - analyzing and accumulating information for regulatory reporting;
 - assisting in the preparation of consolidated financial statements (including assisting in the translation of local statutory accounts to comply with group accounting policies and transition to a different reporting framework such as International Financial Reporting Accounting Standards);
 - assisting the drafting of disclosure items;
 - proposing adjusting journal entries; and
 - providing assistance and advice in the preparation of local statutory accounts of subsidiary entities.
- 139** A self-review threat may exist when a member, firm or network firm assists in the preparation of subject matter other than financial statements and subsequently provides assurance thereon. –For example, a self-review threat will exist if a member or firm develops and prepares prospective financial information and subsequently provides assurance on it. Consequently, a member or firm should evaluate the significance of any self-review threat created by the provision of such a service. If the threat is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level.
- Audit or review clients that are not reporting issuers or listed entities*
- 140** Subject to Rule 204.4(23) a member, firm or network firm may provide an audit or review client or related entity that is not a reporting issuer or listed entity with accounting and

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bookkeeping services provided that any resulting self-review threat so created is reduced to an acceptable level. Examples of such services include:

- recording transactions for which management ~~the client~~ has determined or approved the appropriate account classification;
- posting transactions to the ~~client's~~ general ledger;
- preparing financial statements;
- drafting notes to the financial statements;
- posting journal entries to the trial balance;
- performing payroll services which do not involve having custody of the client's or related entity's assets; and
- preparing tax receipts for charitable donations or tax information returns, such as T4 slips.

Client approval of journal entries

- 141 A member, firm or network firm may prepare journal entries for an audit or review client or related entity that is not a reporting issuer or listed entity provided management approves and takes responsibility for such journal entries. In obtaining this approval, the member, firm or network firm may choose to obtain approval for each journal entry or, alternatively, to obtain approval following a thorough review of the completed financial statements with management. This approval may also be obtained through the management representation letter.

Evaluation of significance of threats

- 142 The significance of a threat created by providing accounting and bookkeeping services to an audit or review client or related entity that is not a reporting issuer or listed entity should be evaluated. The significance of such a threat will depend upon factors such as:

- the degree of involvement of the member or firm;
- the complexity of the transactions to be accounted for; and
- the extent of professional judgment required in selecting the appropriate accounting treatment.

If the threat is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:

- making arrangements so that such services are not performed by a person on the engagement team;
- requiring the client or related entity to create the source data for the accounting entries;
- requiring the client or related entity to develop the underlying assumptions;
- obtaining the views of another professional accountant;
- arranging for another firm to review a significant accounting treatment; or
- discussing a significant accounting treatment with the practice advisory services

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department of the member's provincial institute [or name of other appropriate department].

Complex transactions

143 Preparing the journal entries for a complex transaction would likely create a self-review threat the significance of which could only be reduced to an acceptable level by applying safeguards that involve consultation with others, for example by:

- obtaining the views of another professional accountant;
- arranging for another firm to review a significant accounting treatment; or
- discussing the proposed accounting treatment with the practice advisory services department of the member's provincial institute [or name of other appropriate department]

Audit clients that are reporting issuers or listed entities

144 Rule 204.4(24) provides that, in other than emergency situations, during either the period covered by the financial statements subject to audit or the engagement period, a member, a firm or a network firm, or a member of the firm or a network firm, may not provide bookkeeping or other services related to the accounting records or financial statements of an audit client that is a reporting issuer or listed entity, or of a related entity, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the financial statements. Bookkeeping and other such services include:

- maintaining or preparing the entity's, or a related entity's, accounting records;
- preparing the financial statements on which the audit report is provided or that form the basis of the financial statements on which the audit report is provided; and
- preparing or originating source data underlying ~~the~~ such financial statements.

In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the bookkeeping or other services will be subject to audit procedures.

Rule 204.4(24) permits the provision of such accounting or bookkeeping services by a member, a firm or a network firm, or a member of the firm or a network firm in the event of emergency situations provided that the requirements Rule 204.4(24) are met. Such emergency situations might arise when, due to events beyond the control of the member or firm and the client or related entity:

(a) there are no viable alternative resources to those of the member or firm with the necessary knowledge of the client's or related entity's business to assist in the timely preparation of its accounting records or financial statements; and

(b) a restriction on the member's or firm's ability to provide the services would result in significant difficulties for the client or related entity, for example, as might result from a failure to meet regulatory reporting requirements, in the withdrawal of credit lines, or would threaten the going concern status of the client or related entity. Significant difficulties would not be created simply by virtue of the fact that the client or related entity would be required to incur additional costs to engage the services of an alternative service provider.

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Members and firms are also required by Rule 204.5(b) to document both the rationale supporting the determination that the situation constitutes an emergency and compliance with the provisions of subparagraphs (i) through (iv) of Rule 204.4(24).

Members, firms and network firms should fully assess and consider the circumstances that would constitute an emergency situation. Emergencies situations are rare, non-recurring and would arise only when clearly beyond the control of the member or firm and the client or related entity. Caution should be exercised when deciding to undertake services under this exception.

Valuation services

General provisions

- 145** A valuation service involves the making of assumptions with respect to future events and the application of certain methodologies and techniques, in order to compute an amount or provide an opinion with respect to a specific value or range of values, for a business as a whole, an intangible or tangible asset or a liability.
- 146**~~150~~ When a member or firm performs a valuation that forms part of the subject matter of an assurance engagement that is not an audit or review engagement, the firm should consider whether there is a self-review threat. If such a threat exists, and it is other than clearly insignificant, safeguards should be applied to eliminate it or reduce it to an acceptable level.

Audit or review clients that are not reporting issuers or listed entities

- 147** Unless a valuation is performed for tax purposes only and relates to amounts that will affect the financial statements subject to audit or review by the member or firm only through accounting entries related to taxation, Rule 204.4(25)(a) provides that, during either the period covered by the financial statements subject to audit or review or the engagement period, a member, a firm, a network firm or a member of a firm or a network firm may not provide a valuation service to an entity or a related entity if the valuation involves a significant degree of subjectivity and relates to amounts that are material to the financial statements subject to audit or review by the member or firm.
- 147A** Members and firms should refer to Council Interpretation 189A when a valuation service is performed for an audit or review client or a related entity for tax purposes only and relates to amounts that will affect the financial statements subject to audit or review by the member or firm only through accounting entries related to taxation.
- 1468** Performing a valuation service for audit or review client or a related entity that is not a reporting issuer or listed entity will create a self-review threat when the valuation resulting from the service is incorporated into the ~~client's~~ financial statements subject to audit or review by the member or firm. The significance of such a threat should be evaluated. The significance will depend on factors such as:
- the materiality of the results of the valuation service;

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- the extent of the client's or related entity's knowledge, experience and ability to evaluate the issues concerned, and the extent of the client's or related entity's involvement in determining and approving significant matters of judgment;
- the degree to which established methodologies and professional guidelines are applied when performing the particular valuation service;
- the degree of subjectivity inherent in the item concerned where the valuation involves standard or established methodologies;
- the reliability and extent of the underlying data;
- the degree of dependence on future events of a nature which could create significant volatility in the amounts involved; and
- the extent and clarity of the financial statement disclosures.

If the threat is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- involving an additional professional accountant who was not a member of the engagement team to review the valuation work or otherwise advise as necessary;
- confirming with the client or related entity its understanding of the underlying assumptions of the valuation and the methodology to be used and obtaining approval for their use;
- obtaining the client's or related entity's acknowledgement of responsibility for the results of the valuation work performed by the firm or network firm; or
- arranging that members of the firm or network firm providing such services do not participate on the engagement team.

~~147 Performing a valuation service for an audit or review client that is not a reporting issuer involving matters that are material to the entity's financial statements and involving a significant degree of subjectivity would likely create a self-review threat. The significance of such a threat could only be reduced to an acceptable level by applying safeguards that involve consultation with others, such as another professional accountant or valuation specialist.~~

~~148 When a member, firm or network firm performs a valuation service for an audit or review client or a related entity for the purposes of making a filing with a taxation authority, computing an amount of tax due by the client, or tax planning, no significant threat to independence ordinarily exists because such valuations are generally subject to the safeguard of external review by the taxation authority.~~

~~149 Certain valuations do not involve a significant degree of subjectivity. This is likely the case where the underlying assumptions are either established by law or regulation, or are widely accepted and when the techniques and methodologies to be used are based on generally accepted standards or prescribed by law or regulation. In such circumstances, the results of a valuation performed by two or more parties are not likely to be materially different.~~

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~~15049~~ ~~Notwithstanding Rule 204.4(25)(a),~~ ~~the independence of a member or a firm will not be impaired when:~~

- the firm's valuation specialist reviews the work of an audit or review client or a related entity or a specialist employed by the client or related entity, provided the client, related entity or ~~the client's~~ specialist supplies the technical expertise that the client or related entity uses in determining the required amounts recorded in the financial statements. In such circumstances there will be no self-review threat because a client's or related entity's management or a third-party is the source of the financial information subject to audit or review by the member or firm; or
- the valuation service is provided for non-financial reporting purposes only, for example, transfer pricing studies or other valuations that are performed solely for tax-only purposes.

Audit clients that are reporting issuers or listed entities

151 Unless the valuation is performed for tax purposes only and relates to amounts that will affect the financial statements subject to audit or review by the member or firm only through accounting entries related to taxation, Rule 204.4(25)(b) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, a firm or a network firm, or a member of the firm or a network firm, may not provide a valuation service to an audit client that is a reporting issuer or listed entity, or to a related entity, unless it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the financial statements. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the valuation service will be subject to audit procedures.

151A Members and firms should refer to Council Interpretation 189A when a valuation service is performed for a client that is a reporting issuer or listed entity, or for a related entity, for tax purposes only and relates to amounts that will affect the financial statements subject to audit or review by the member or firm only through accounting entries related to taxation.

~~Provision of a~~ **Actuarial services to a reporting issuer or listed entity audit client**

152 Rule 204.4(26) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, firm or network firm, or a member of the firm or a network firm, may not perform an actuarial service for an audit client that is a reporting issuer or listed entity, or for to a related entity, unless it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the financial statements. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the actuarial service will be subject to audit procedures.

153 For the purposes of Rule 204.4(26), actuarial services include the determination of an amount to be recorded in the client's financial statements and related accounts, except for: services that involve assisting the client in understanding the methods, models, assumptions and inputs used in determining such amounts; and advising management on the appropriate actuarial methods and assumptions that will be used in the actuarial valuations. In addition, the firm may use its own actuary to assist in conducting the audit if

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the client's actuary or a third-party actuary provides management with its actuarial capabilities.

~~Provision of internal audit services to an audit or review client~~

General provisions

- 154 A self-review threat may exist when a member, firm or network firm provides internal audit services to an audit or review client or a related entity. Such services may comprise an extension of the firm's audit service beyond the requirements of generally accepted auditing standards, assistance in the performance of the client's or related entity's internal audit activities, or outsourcing of the activities. In evaluating any threat to independence, the nature of the service should be considered.
- 155 Services involving an extension of the procedures required to conduct an audit or review in accordance with the *CICA Handbook – Assurance* will not be considered to impair independence with respect to an audit or review client provided that a member of the firm or network firm does not act or appear to act in the capacity of the client's or related entity's management.
- 156 During the course of an audit or review engagement the engagement team considers the client's internal controls and, as a result, may make recommendations for its improvement. This is part of an audit or review engagement and is not considered to be an internal audit service
- 157 ~~*Intentionally left blank.* For the purposes of Rule 204.4 and this Council Interpretation, internal audit services do not include operational internal audit services unrelated to the internal accounting controls, financial systems or financial statements.~~
- 158 ~~*Intentionally left blank.*~~
- ~~Safeguards that should be applied in all circumstances to reduce any threats created by performing internal audit services for an audit or review client to an acceptable level include ensuring that:~~
- ~~• the client is responsible for internal audit activities and acknowledges in writing, to the firm and the audit committee, its responsibility for establishing, maintaining and monitoring the system of internal controls;~~
 - ~~• the client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;~~
 - ~~• the client or the audit committee approves the scope, risk and frequency of internal audit work;~~
 - ~~• the client is responsible for evaluating and determining which recommendations of the firm should be implemented;~~
 - ~~• the client evaluates the adequacy of the internal audit procedures performed and the findings resulting from the performance of those procedures by, for example, obtaining and acting on reports from the member, firm or network firm; and~~
- ~~the findings and recommendations resulting from the internal audit services performed by the member, firm or network firm are reported appropriately to the audit committee.~~

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- 159 In addition to complying with the requirements of Rule 204.4(27)(a), a member or firm should also consider ~~Consideration should also be given to whether the provision of~~ internal audit services should be provided to an audit or review client or a related entity should be provided only by a member or members of the firm not involved in the audit or review engagement and with different reporting lines within the firm.
- 160 Performing a significant portion of the audit or review client's or related entity's internal audit activities may create a self-review threat and a member, firm or network firm should consider that possibility and proceed with caution before taking on such an activity.
- Audit clients that are reporting issuers or listed entities
- 161 Rule 204.4(27)(b) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, firm or network firm, or a member of the firm or a network firm, may not provide an internal audit service to an audit client that is a reporting issuer or listed entity, or to a related entity, that relates to the client's, or the related entity's, internal accounting controls, financial systems or financial statements, unless it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the financial statements. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the internal audit service will be subject to audit procedures.
- 162 Rule 204.4(27)(b) does not prohibit ~~a the~~ member, firm or network firm from providing a nonrecurring service to evaluate a discrete item or program, if the service is not in substance the outsourcing of an internal audit function. For example, the member, firm or network firm, or a member of the firm of a network firm, may conduct a nonrecurring specified auditing procedures engagement related to the internal controls of an audit client that is a reporting issuer or listed entity or a related entity.

Provision of IT information technology system services to an audit or review client

General provisions

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

There are, however, some information technology systems services that may not create a threat to independence, provided that the member or firm does not make a management decision or perform a management function for the client or the related entity. Such services include the following:

- (a) designing or implementing information technology systems that are unrelated to internal controls over financial reporting;
- (b) designing or implementing information technology systems that do not generate information forming a significant part of the accounting records or financial statements subject to audit or review by the member or firm;

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(c) implementing “off-the-shelf” accounting or financial information reporting software that was not developed by the firm if the customization required to meet the client’s or related entity’s needs is not significant; and

(d) evaluating and making recommendations with respect to a system designed, implemented or operated by another service provider or the client or related entity.

Audit or review clients that are not reporting issuers or listed entities

- 164** ~~*Intentionally left blank.*The provision of services by a member, firm or network firm to an audit or review client that involve both the design and the implementation of such financial information technology systems would create a self-review threat that is likely to be too significant to allow the provision of such services to an audit or review client that is not a reporting issuer, unless appropriate safeguards are put in place ensuring that:~~
- ~~the client acknowledges in writing to the firm and the audit committee its responsibility for establishing and monitoring a system of internal controls;~~
 - ~~the client designates a competent employee, preferably within senior management, with the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system;~~
 - ~~the client makes all management decisions with respect to the design and implementation process;~~
 - ~~the client evaluates the adequacy and results of the design and implementation of the system; and~~
 - ~~the client is responsible for the operation of the system (hardware or software) and the data used or generated by the system.~~

- 165** ~~In addition to complying with the requirements of Rule 204.4(28)(a), a member or firm should also consider~~Consideration should also be given to whether financial information systems design and implementation such services should be provided to an audit or review client or related entity only by members of the firm who are not part of the engagement team involved in the audit or review engagement and with different reporting lines within the firm.

- 166** ~~*Intentionally left blank.*The provision of services by a member, firm or network firm to an audit or review client that involve either the design or the implementation of financial information technology systems that are used to generate information forming part of the client’s financial statements may also create a self-review threat. The significance of any threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to eliminate it or reduce it to an acceptable level.~~

- 167** ~~*Intentionally left blank.*~~
- ~~The provision of services to an audit or review client by a member, firm or network firm in connection with the assessment, design and implementation of internal accounting controls and risk management controls is not considered to create a threat to independence provided that members of the firm or network firm do not perform management functions for the client.~~

- 168** ~~*Intentionally left blank.*~~
- ~~Recommending or installing pre-packaged financial information technology software for~~

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~~an audit or review client that is not a reporting issuer generally will not create a threat to independence.~~

Audit clients that are reporting issuers or listed entities

169 Rule 204.4(28)(b) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, a firm or network firm, or a member of the firm or a network firm, may not design or implement a financial information system for an audit client that is a reporting issuer or listed entity, or for a related entity, unless it is reasonable to conclude that the results of such service will not be subject to audit procedures during an audit of the client's financial statements. Such services involve:

(a) directly or indirectly operating, or supervising the operation of, the entity's, or a related entity's, information system

~~(a)(b)~~ (e) directly or indirectly managing the entity's or a related entity's local area network; or

~~(b)(c)~~ designing or implementing a hardware or software system that aggregates source data underlying the financial statements or generates information that is significant to the entity's, or a related entity's, financial statements or other financial information systems taken as a whole; ~~or~~

~~(c) directly or indirectly managing the entity's, or a related entity's, local area network.~~

In determining whether it is reasonable to conclude that the results of such service will not be subject to audit procedures, there is a rebuttable presumption that the results of the financial information systems design and implementation service will be subject to audit procedures.

170 Information will be considered to be significant if it is ~~reasonably~~ likely to be material to the financial statements. Since materiality determinations may not be complete before the financial statements are prepared, the audit client or related entity and the member or firm should evaluate the general nature of the information as well as system output during the period of the audit engagement.

171 Notwithstanding Rule 204.4(28), a member, a firm or a network firm may:

- design or implement a hardware or software system that is unrelated to the financial statements or accounting records of the reporting issuer or listed entity, or a related entity;
- as part of the audit, or another assurance engagement, evaluate and make recommendations to management on the internal controls of a system as it is being designed, implemented or operated; or
- make recommendations on internal control matters to management or other service provider in conjunction with the design and installation of a system by another service provider.

~~Provision of litigation support or expert services to an audit or review client~~

General provisions

172 Litigation support services include such activities as acting as an expert witness,

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calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute, and assistance with document management and retrieval in relation to a legal dispute or litigation.

173 A self-review threat may exist when a member, firm or network firm provides to an audit or review client or related entity, litigation support services that include the estimation of the possible outcome of a dispute or litigation and thereby affects the amounts or disclosures to be reflected in the client's or related entity's financial statements. The significance of any such threat will depend upon factors such as:

- the nature of the engagement;
- the materiality of the amounts involved; and
- the degree of subjectivity inherent in the matter concerned.

The member or firm should evaluate the significance of any threat so created and, if it is other than clearly insignificant, safeguards should be applied to eliminate it or reduce it to an acceptable level. Such safeguards might include:

- policies and procedures to prohibit individuals who assist the client from making management decisions on the client's or related entity's behalf;
- using a member of the firm who is not part of the engagement team to perform the litigation support service; or
- the involvement of others, such as independent specialists.

If adequate safeguards are not available to reduce a threat to an acceptable level the member, firm or network firm should decline the engagement.

Audit or review clients that are not reporting issuers or listed entities

174 Rule 204.4(29)(a) provides that, during either the period covered by the financial statements subject to audit or review or the engagement period, a member, a firm or a network firm, or a member of the firm or a network firm, may not provide a litigation support service for an audit or review client, or for a related entity, or for a legal representative thereof, if the amounts involved in the matter are material to the financial statements that are subject to audit or review by the member or firm.

Provision of expert services to a Audit clients that are reporting issuers or listed entities audit client

174A Rule 204.4(29)(b) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, a firm or a network firm, or a member of the firm or a network firm, may not provide a litigation support an expert opinion or other expert service for an audit client that is a reporting issuer or listed entity, or for a related entity, or for a legal representative thereof.

174B The effect of Rule 204.4(29) is to prohibit, except for the specified circumstances set out in paragraph 202.4(29)(a), ~~This rule prohibits~~ a member, firm or network firm, or a member of the firm or a network firm, from ~~performing an engagement to provide~~ providing specialized knowledge, experience or expertise to advocate or support the audit client's positions, or the positions of a related entity, in an adversarial or similar proceeding such as an investigation, a litigation matter, or a legislative or administrative

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tribunal. Litigation or other matters frequently escalate to a level, such as a civil, criminal, regulatory, administrative or legislative proceeding or investigation, which creates a self-review or advocacy threat which cannot be reduced to an acceptable level by available safeguards. Accordingly, it is particularly important for members and firms to consider initially, and thereafter reconsider periodically, whether the matter in support of which the service is provided is likely to escalate, or has escalated, to such a level. In addition, members and firms should discuss, with the audit committee, the possibility that a matter could escalate to such a level and the consequential impact on the member's or firm's ability to continue to provide the litigation support service or to continue to perform the audit or review engagement.

175 Notwithstanding Rule 204.4(29), a member, a firm or a network firm, or a member of the firm or a network firm, may be engaged by an audit committee of an audit or review client ~~that is a reporting issuer~~ to assist it in fulfilling its responsibilities to conduct its own investigation of a potential accounting impropriety. For example, if the audit committee is concerned about the accuracy of the inventory records at a subsidiary, it may engage the member, the firm or the network firm, or a member of the firm or a network firm, to conduct a thorough inspection and analysis of these records, the physical inventory at the subsidiary and related matters without impairing independence. This type of engagement may include forensic or other fact-finding work that results in the issuance of a report to the audit client. It will generally require performing procedures that are consistent with, but more detailed or more comprehensive than, those required by generally accepted auditing standards.

176 In an investigation or proceeding for an audit or review client ~~that is a reporting issuer~~, or for a related entity, the member, firm or network firm, or a member of the firm or a network firm, may provide an account or testimony with respect to a matter of fact, such as describing the work performed by the member's firm or the predecessor auditor. The member, firm or network firm, or a member of the firm or network firm, may explain the positions taken or the conclusions reached during the performance of any service provided for the ~~reporting issuer~~ audit or review client.

Legal services to an audit or review client

General provisions

177 A legal service is ~~refers to~~ any service that may only be provided by a person licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided. However, where a jurisdiction outside of Canada requires a service to be provided by a person licensed, admitted, or otherwise qualified to practice law in that jurisdiction and the same service could be provided in the relevant jurisdiction in Canada by a person not licensed, admitted, or otherwise qualified to practice law, such a service is not considered to be a legal service. Legal services encompass a wide and varied range of corporate and commercial services, including contract support, conduct of litigation, mergers and acquisition advice and support and the provision of assistance to client's internal legal departments. ~~For the purposes of Rule 204.4 legal services do not include those taxation services that may be provided by a person who is not admitted to the practice of law in the jurisdiction.~~

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178 Threats to independence created by the provision of legal services to an audit or review client or related entity should be considered based on:

- the nature of the service to be provided (for example, advocacy as opposed to other legal services);
- whether the service provider is separate from the engagement team; and
- the materiality of any pertinent matter in relation to the ~~client's~~ financial statements that are subject to audit or review by the member or firm.

179 The provision of a legal service which involves matters that would not be expected to have a material effect on the ~~client's~~ financial statements subject to audit or review by the member or firm is not considered to create an unacceptable threat to independence with respect to the engagement to perform the audit or review of those financial statements that client.

180 The provision of ~~a~~ legal services to support an audit or review client or related entity in the execution of a transaction (e.g., contract support, legal advice, legal due diligence and restructuring) may create a self-review threat. The significance of any such threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- using ~~a~~ members of the firm who are ~~is~~ not on the engagement team to provide the service;
- ~~ensuring the member of the firm does not make a management decision for the client or related entity;~~
- ensuring the client or related entity makes the ultimate decision in relation to the advice provided; or and
- ensuring the service involves the execution of what has been decided by the client or related entity in relation to the transaction.

Audit or review clients that are not reporting issuers or listed entities

181 ~~Notwithstanding the foregoing~~, Rule 204.4(30) provides that a member, firm or network firm may not, during either the period covered by the financial statements subject to audit or review or the engagement period, provide a legal service to an audit or review client or related entity in the resolution of a dispute or litigation in circumstances where the matters in dispute or subject to litigation are material in relation to the ~~client's~~ financial statements subject to audit or review by the member or firm.

182 The provision of a legal service to assist an audit or review client or related entity in the resolution of a dispute or litigation may create an advocacy or self-review threat. When a member, firm or network firm is asked to act in an advocacy role for the client or related entity in the resolution of a dispute or litigation in circumstances where the amounts involved are not material to the client's financial statements, the significance of any resulting threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to eliminate it or reduce it to an acceptable level. Such safeguards might include:

- policies and procedures to prohibit members of the firm or network firm from

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assisting the client or related entity in making management decisions on behalf of the client or related entity; or

- using members of the firm who are not on the engagement team to perform the particular legal service.

Audit clients that are reporting issuers or listed entities

- 183** Rule 204.4(31) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, firm or network firm, or a member of the firm or a network firm, may not provide a legal service to an audit client that is a reporting issuer or listed entity, or to a related entity.

Human resource services for an assurance client

General provisions

- 184** The recruitment of managers, executives or directors for an assurance client, where the person recruited will be in a position to affect the subject matter of the assurance engagement, may create a current or future self-interest, familiarity or intimidation threat. The significance of such a threat will depend upon factors such as:

- the role of the person to be recruited; and
- the nature of the assistance sought.

The significance of any such threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. In all cases, the firm should not make management decisions and the client should make the hiring decision.

Audit clients that are reporting issuers or listed entities

- 185** Rule 204.4(32) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, firm or network firm, or a member of the firm or a network firm, may not provide any of the following services to an audit client that is a reporting issuer or listed entity, or to a related entity:

- (a) searching for or seeking out prospective candidates for management, executive, or director positions;
- (b) engaging in psychological testing, or other formal testing or evaluation programs;
- (c) undertaking reference checks of prospective candidates for an executive or director position;
- (d) acting as a negotiator or mediator ~~on the entity's behalf~~ with respect to employees or future employees with respect to any condition of employment, including position, status or title, compensation, or fringe benefits; or
- (e) recommending or advising ~~the entity with respect~~ to ~~hire~~ing a specific candidate for a specific job.

Notwithstanding Rule 204.4(32) a member, firm or network firm, or a member of the firm or a network firm may, upon request of the audit client or a related entity, interview candidates and advise the client or related entity on the candidate's competence for financial accounting, administrative or control positions.

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Corporate finance and similar services activities

~~186~~ Rule 204.4(33) provides that, during the engagement period, a member or firm, or a member of the firm may not provide any of the following services to an assurance client:

- ~~(a) promoting, dealing in or underwriting the client's securities;~~
- ~~(b) making investment decisions on behalf of the client or otherwise having discretionary authority over the client's investments;~~
- ~~(c) executing a transaction to buy or sell the client's investments; or~~
- ~~(d) having custody of assets of the client, including taking temporary possession of securities purchased by the client.~~

~~The Rule further provides that in the case of an assurance client that is an audit or review client, during either the period covered by the financial statements subject to audit or the engagement period, a network firm or a member of a network firm shall not provide such services to the client.~~

~~It also provides that in the case of an audit client that is a reporting issuer, the firm, a network firm, or a member of the firm or network firm shall not provide such services to a related entity.~~

186 Rule 204.4(33) sets out in paragraphs (a) to (e) the corporate finance and similar services which a member or firm may not provide to an audit or review client or a related entity.

Where a member or firm has provided advice on corporate finance matters to such a client or entity, Rule 204.4(33)(b) prohibits the member or firm from performing the audit or review engagement if:

- (a) the effectiveness of the advice depends on a particular accounting treatment or presentation in the financial statements;
- (b) the outcome or consequences of the advice has or will have a material effect on the financial statements; and
- (c) the engagement team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework.

Where the efficacy of implementing such corporate finance advice depends upon a particular accounting treatment or presentation, there may be pressure to adopt an accounting treatment or presentation that is inconsistent with the relevant financial reporting framework. If such an inconsistency were to exist, the member or firm would be prohibited from performing the audit or review engagement. Accordingly, where the circumstances set out in (a) exist the member or firm must review the materiality of the effect of the advice and the appropriateness of the related accounting treatment and presentation with the audit or review engagement team as soon as possible prior to completion of the corporate finance advisory service.

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187 ~~Other~~ Corporate finance services other than those that are prohibited by Rule 204.4(33) may create an advocacy or self-review threat that may be reduced to an acceptable level by the application of safeguards. Examples of such services include:

- assisting a client in developing corporate strategies;
- assisting a client in obtaining bank financing by explaining the financial statements to the bank;
- assisting in identifying or introducing a client to possible sources of capital that meet the client specifications or criteria; and
- providing structuring advice and assisting a client in analyzing the accounting effects of proposed transactions.

The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such a safeguards might be include:

~~policies and procedures to prohibit members of the firm from making management decisions on behalf of the client; and~~

using members of the firm who are not part of the engagement team to provide the services.

Provision of ~~t~~ Taxation services to an audit or review client

General provisions

188 ~~Members and firms have historically provided a broad range of tax services to their audit and review clients, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes. Taxation services are seen to be unique among non-assurance services for several reasons. Detailed tax laws must be consistently applied, and taxation authorities have discretion to audit any tax filing. Accordingly such engagements are generally not seen to create threats to independence that are not adequately offset by available safeguards.~~

Tax services usually include:

- preparation of tax returns;
- preparation of valuations for tax purposes;
- provision of tax planning and similar tax advisory services on such matters as how to structure business affairs in a tax efficient manner or on the application of tax laws or regulations;
- provision of tax advocacy services with respect to tax disputes; or
- preparation of tax calculations for the purpose of preparing accounting entries.

188A The provision of tax services may create a self-review threat where the advice or other service affects or will affect the financial statements subject to audit or review by the member or firm, or an advocacy threat where the services involve resolution of a tax dispute with tax authorities. The existence and significance of any threat will depend on factors such as:

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- the nature of the tax service that is provided;
- the degree of subjectivity involved in determining the appropriate treatment of tax advice in the financial statements;
- the extent to which the outcome of the tax service has or will have a material effect on the financial statements subject to audit or review by the member or firm ;
- the level of tax expertise of the client's employees;
- the extent to which the advice is supported by tax law or regulation, other precedent or established practice; and
- whether the tax treatment is supported by a private ruling or has otherwise been cleared by the tax authority before the preparation of the financial statements.

Providing tax planning advice where the advice is clearly supported by tax authorities or other precedent, by established practice or has a basis in tax law that is likely to prevail does not ordinarily create a threat to independence, unless the circumstances described in Rule 204.4(34)(a) exist.

188B The significance of any threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Examples of such safeguards include:

- using professionals who are not members of the assurance engagement team to perform the tax service;
- having a tax professional, who was not involved in providing the tax service, advise the assurance engagement team on the service and review the financial statement treatment;
- obtaining advice on the service from an external tax professional; and
- obtaining pre-clearance or advice from the tax authorities.

Provision of specific tax services

Preparation of tax returns

189 ~~There are however, some taxation services which, when provided to an audit or review client, may impair the independence of the member or firm. An example is when a member, a firm or a network firm represents an audit or review client before a courthaving jurisdiction to deal with tax matters.~~

Tax return preparation services may involve assisting an audit or review client with its tax reporting obligations by drafting and completing information, including the amount of tax due, as reported on prescribed forms, and as required to be submitted to the applicable tax authorities. Such tax returns are subject to audit or other review by tax authorities. Accordingly, the provision of such services does not ordinarily create a threat to independence provided that management takes responsibility for the returns including any significant judgments made.

Preparation of valuations for tax purposes

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189A A firm may be requested to perform a valuation to assist an audit or review client or a related entity with its tax reporting obligations or for tax planning purposes.

(a) Rule 204.4(25) permits the provision of certain valuation services for tax purposes only. Where the valuation is performed for tax purposes only and the valuation relates to amounts that will affect the financial statements subject to audit or review by the member or firm only through accounting entries related to taxation, a threat to independence would not ordinarily be created if the amounts related to the valuation are not material to such financial statements or if the valuation is subject to external review at the discretion of a tax authority or similar regulatory authority.

(b) However, a valuation service referred to in paragraph (a) that is not subject to such an external review and which results in amounts that are material to the financial statements subject to audit or review by the member or firm, may create a threat to independence. The existence and significance of any threat created will depend upon factors such as:

- the extent to which the valuation methodology is supported by tax law or regulation, other precedent or established practice and the degree of subjectivity inherent in the valuation; and
- the reliability and extent of the underlying data.

The significance of any threat created should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level.

Provision of tax planning or other tax advisory services

189B Members and firms often provide tax planning or advisory services in order to create tax-efficient outcomes for their clients. Where a member or firm has provided tax planning or other tax advice to an audit or review client or a related entity, Rule 204.4(34)(a) prohibits the member or firm from performing the audit or review engagement if:

(a) the effectiveness of the advice depends on a particular accounting treatment or presentation in the financial statements;

(b) the outcome or consequences of the advice has or will have a material effect on the financial statements; and

(c) the engagement team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework.

Where the efficacy of implementing such tax planning or other tax advice depends upon a particular accounting treatment or presentation there may be pressure to adopt an accounting treatment or presentation that is inconsistent with the relevant financial reporting framework. If such an inconsistency were to exist, the member or firm would be prohibited from performing the audit or review engagement. Accordingly, where the circumstances set out in (a) exist, the member or firm must review the materiality of the effect of the tax planning or other tax advice and the appropriateness of the related accounting treatment or presentation with the audit or engagement team as soon as possible prior to completion of the tax planning or other tax advisory service.

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Provision of tax advocacy services

189C Tax advocacy services generally involve assisting a client in the resolution of a disputed tax matter with tax authorities. Such services may involve the provision of litigation support services, legal services or both. Accordingly, members and firms should evaluate whether the provision of such a tax advocacy service involves the provision of a service that would be prohibited pursuant to Rules 204.4(29)(a) or (b), (30) or (31).

Audit or review clients that are not reporting issuers or listed entities

Rules 204.4(29)(a) and (30) do not preclude members and firms from providing a tax advocacy service that involves assistance in the resolution of a dispute with a tax authority to an audit or review client that is not a reporting issuer or listed entity and where the assistance does not involve acting as an advocate before a public tribunal or court.

Members and firms are also not precluded by Rules 204.4(29)(a) and (30) from providing a tax advocacy service that involves assistance in the resolution of a dispute with a tax authority to an audit or review client that is not a reporting issuer or listed entity where the assistance involves acting as an advocate before a public tribunal or court provided that the disputed matter involves amounts that are not material to the financial statements subject to audit or review by the member or firm.

Rules 204.4(29)(a) and (30) do not preclude members and firms from responding to specific requests for information, providing factual accounts or testimony about the work performed or assisting the client in analyzing the tax issues.

Audit clients that are reporting issuers or listed entities

Rules 204.4(29)(b) and (31) do not preclude members and firms from providing a tax advocacy service that involves assistance in the resolution of a dispute with a tax authority to a reporting issuer or listed entity audit client and where the assistance does not involve acting as an advocate before a public tribunal or court.

Pursuant to Rules 204.4(29) and (31), members and firms may not provide a tax advocacy service that involves assistance in the resolution of a dispute with a tax authority to a reporting issuer or listed entity audit client and where the assistance involves acting as an advocate before a public tribunal or court whether or not the amounts involved are material to the financial statements subject to audit or review by the member or firm.

Rules 204.4(29)(b) and (31) do not preclude members and firms from responding to specific requests for information or providing factual accounts or testimony about the work performed.

Members and firms are cautioned that an engagement to provide a permitted tax advocacy service may, in its performance, escalate to a point where the advocacy or self-review threat so created cannot be reduced to an acceptable level by the application of safeguards. Accordingly, the guidance in Council Interpretation 174B applicable to litigation support services may also be helpful when considering the provision of tax

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advocacy services. One of the factors that impacts the significance of any such threat created is whether the tax advocacy service involves acting as advocate before a public tribunal or court, which for this purpose is an adjudicative body that is independent of the tax authority.

Preparation of tax calculations for the purpose of preparing accounting entries for a reporting issuer or listed entity

189D Rule 204.4(34)(b) permits, in the event of an emergency situation and under specified conditions, a member or firm to prepare tax calculations of current and future tax liabilities or assets for a reporting issuer or listed entity audit client or a related entity for the purpose of preparing accounting entries that are subject to audit by the member or firm. Such emergency situations might arise when, due to events beyond the control of the member or firm and the client or related entity:

- (a) -there are no viable alternative resources to those of the member or firm with the necessary knowledge of the client's or related entity's business to assist in the timely preparation of such tax calculations; and
- (b) a restriction on the member's or firm's ability to provide the services would result in significant difficulties for the client or related entity, for example, as might result from a failure to meet regulatory reporting requirements, in the withdrawal of credit lines, or would threaten the going concern status of the client or related entity. Significant difficulties would not be created simply by virtue of the fact that the client or related entity would be required to incur additional costs to engage the services of an alternative service provider.

Members and firms are also required by Rule 204.5(c) to document both the rationale supporting the determination that the situation constitutes an emergency and compliance with the provisions of subparagraphs (i) through (iv) of Rule 204.4(34)(b).

Members, firms and network firms should fully assess and consider the circumstances that would constitute an emergency situation. Emergency situations are rare, non-recurring and would arise only when clearly beyond the control of the member or firm and the client or related entity. Caution should be exercised when deciding to undertake services under this exception.

M. FEES AND PRICING

Fees — Pricing

190192 Rule 204.4(365) provides that a member or firm may not provide an assurance service at a fee level that the member or firm knows is significantly lower than that charged by the predecessor member or firm, or contained in other proposals for the engagement, unless the member or firm can demonstrate that the engagement will be performed properly by qualified staff and in accordance with all applicable professional standards.

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Fees — Relative size

1910 When the total fees generated from an assurance client represent a significant proportion a member's or firm's total fees, the financial dependence on that client, or group of clients of which it is a part, including the possible concern about losing the client, may create a self-interest threat. The significance of the threat will depend upon factors such as:

- the structure of the firm; and
- whether the member or firm is well established in practice.

The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- taking steps to reduce the dependency on the client;
- discussing the extent and nature of fees with the audit committee;
- having firm policies and procedures to monitor and implement quality control of assurance engagements;
- involving another member of the firm who is not on the engagement team to review the work done or advise as necessary;
- arranging for external quality control reviews; or and
- consulting a third party, such as a professional regulatory body or a professional colleague who is not a member of the firm.

Relative size of fees of a reporting issuer or listed entity audit client

191A Rule 204.4(37)(a) provides that, unless specified measures are taken, a member or firm may not perform an audit engagement for a client that is a reporting issuer or listed entity, when, for the two consecutive fiscal years of the firm concluded most recently concluded prior to the date of the financial statements subject to audit by the member or firm, the total revenue, calculated on an accrual basis, for services provided to that client and its related entities represent more than 15% of the total revenue of the firm, calculated on an accrual basis, in each such fiscal year. The measures required to be taken by the rule are:

- disclosing, to the audit committee, that the revenue exceeds the 15% threshold; and
- completion, by another professional accountant who is not a member of the firm, of either a “pre-issuance” or “post-issuance” review of the audit engagement.

The rule requires that either such review be substantially equivalent to an engagement quality control review. In the case of a “pre-issuance” review, the review is to be completed prior to the audit opinion in respect of the financial statements being issued. A “post-issuance” review may be completed after the audit opinion in respect of the financial statements has been issued but prior to the audit opinion on the client's financial statements for the immediately following fiscal period being issued.

The rule also requires the performance of a “pre-issuance” review if the total revenue,

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calculated on an accrual basis, for any services provided to the client continue to represent more than 15% of the total revenue of the firm, calculated on an accrual basis, in the firm's most recently concluded fiscal year.

191B Rule 204.4(37)(b) provides that a member or firm may not accept an engagement to perform the "pre-issuance" or "post-issuance" review required by Rule 204.4(37)(a)(ii) if any of the provisions of Rule 204 would prevent the member or firm from performing the audit of the financial statements referred to in Rule 204.4(37)(a).

Fees — Overdue

1924 A self-interest threat may exist if fees due from an assurance client for professional services remain unpaid for a long time, especially if a significant portion is not paid before the issue of the assurance report for the following year. Generally the payment of such fees should be required before that report is issued. The following safeguards may be applicable:

- discussing the level of outstanding fees with the audit committee; and
- involving another member of the firm who is not part of the engagement team, or a professional colleague who is not a member of the firm, to provide advice or review the work performed.

Members are cautioned that the overdue fees might create the same threats to independence as a loan to the client. Therefore, members should consider whether, because of the significance of such threats, it is appropriate for the firm to continue to provide assurance services to that ~~retain the~~ client.

N. EVALUATION AND COMPENSATION OF ENGAGEMENT TEAM AUDIT PARTNERS

General provisions

193 Evaluating or cCompensating a member of the engagement team for an audit or review client-an audit partner for selling non-assurance services to that an-audit or review client, of that partner may create a self-interest threat. The significance of the threat will depend on such factors as:

- the structure of the firm;
- the size of the fee for the assurance service; and
- the size of the fee for the non-assurance service.

The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- discussing the nature and extent of the fees with the audit committee;
- having firm policies and procedures to monitor and implement quality control of assurance engagements;

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- involving another member of the firm who is not a member of the engagement team to review the work done or advise as necessary; ~~or~~ **and**
- being subject to external practice inspection.

Audit clients that are reporting issuers

194 Rule 204.4(~~38~~**5**) provides that a member who is ~~an audit partner~~ a key audit partner with respect to an audit or review engagement of a firm with five or more audit clients that are reporting issuers or ten or more partners, may not ~~be evaluated or compensated~~ earn or receive compensation based on ~~such a the partner selling top~~ procuring engagements from a reporting issuer audit the audit or review client or a related entity, ~~of the partner to provide any product or service other than an assurance service. Rule 204.4(35) does not apply to partners who are not “audit partners” as defined~~

195 ~~Notwithstanding the above, such a key audit partner may be~~ The prohibition from compensating an audit partner for procuring or selling non-assurance services is not extended to compensation evaluated or compensated in relation to ~~for performing such services and~~ may does not preclude an audit partner from sharing share in the profits of the audit practice and the profits of the firm. ~~Such a~~ An audit partner's evaluation may take into account a number of factors, including directly or indirectly related to selling services to an audit client that is a reporting issuer. For example, an audit partner may be evaluated on the complexity of his or her engagements, the overall management of the relationship with the client including the provision of non-audit services, and the attainment of specific ~~sales goals~~ for the sale of assurance services to a client for which the partner is a key audit partner or for the sale of any services to a client for which the partner is not a key audit partner.

Members and firms should consider documenting their evaluation and compensation processes and systems in order to demonstrate compliance with the requirements of Rule 204.4(38)

O. CONTINGENT FEES

196 Members and firms are referred to Rule 215 and the related Council Interpretation.

P. GIFTS AND HOSPITALITY

197 Rule 204.4(~~39~~**6**) provides that a firm, or a member or ~~a~~ student who is part of an engagement team for an assurance client, may not accept a gift or hospitality, including a product or service discount, from the client unless the gift or hospitality is clearly insignificant to the firm or person as the case may be.

Q. ACTUAL OR THREATENED LITIGATION

198 Actual, threatened or prospective litigation between a firm or a member of an engagement team and the assurance client or a shareholder or creditor of the client may create a self-interest or intimidation threat. The relationship between client management and persons on the engagement team should be characterized by complete candour and full disclosure regarding all aspects of the client's business operations and all

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matters relevant to the client's financial statements. The firm and the client's management may be placed in adversarial positions by actual, threatened or prospective litigation, which could impair complete candour and full disclosure, and in this, or other ways, the firm may face a self-interest or intimidation threat. The significance of the threat will depend upon such factors as:

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

The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- disclosing to the audit committee the extent and nature of the litigation;
- removing from the engagement team any person involved in the litigation; **or**
- involving an additional member of the firm who is not part of the engagement team to review the work done or advise as necessary.

If such safeguards do not reduce the threat to an acceptable level, the only appropriate action is for the member or firm to withdraw from, or refuse to accept, the assurance engagement.

- 199** Members are cautioned that actual litigation often results in a conflict of interest between the client and the member or firm which will preclude the member or firm from continuing to provide professional services to the client. Threatened or prospective litigation can have the same result. When faced with threatened, prospective or actual litigation, members and firms should refer to Rule 210 and the related Council Interpretation, and consult with their legal counsel, to determine whether they can continue to provide professional services to the client and, if so, whether there are particular arrangements which should be made with the client.

R. CLIENT MERGERS AND ACQUISITIONS

200 Where, as a result of a merger or acquisition, another entity merges with or becomes a related entity of an audit or review client, the existence of a previous or current activity, interest or relationship with the other entity may impair the member's or firm's independence in relation to the audit or review engagement. Independence may be impaired either by a specific prohibition established by Rule 204.4 or from threats to independence which could not be reduced to an acceptable level by applying appropriate safeguards in accordance with Rule 204.3.

200A Rule 204.4(40) permits, in specified circumstances, a member or firm to perform or continue with an audit or review engagement in a situation where the existence of such an activity, interest or relationship would otherwise impair the independence of the member or firm and require the member or firm to resign from the audit or review engagement.

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- 200B** Rule 204.4(40)(a)(i) permits the member or firm to perform or continue with the audit or review engagement if the particular activity, interest or relationship is terminated by the effective date of the merger or acquisition.
- 200C** Rule 204.4(40)(a)(ii) permits the member or firm to perform or continue with the audit or review engagement if the particular activity, interest or relationship is terminated as soon as reasonably possible, and in all cases, within six months of the merger or acquisition and if the provisions of Rule 204.4(40)(b) are met. For this purpose, “as soon as reasonably possible” means as soon as practicable, having regard to the nature of the activity, interest or relationship and the consequential impact of the termination of the activity, interest or relationship on the client.
- 200D** Rule 204.4(40)(a)(iii) permits the member or firm to perform or continue with the audit or review engagement if the member or firm has completed a significant amount of work on the audit or review engagement and expects to complete the engagement within a short period of time, does not continue as the audit or review service provider beyond the completion of the engagement, either by the member’s or the firm’s own choice or by being replaced by the client, and if the provisions of Rule 204.4(40)(b) are met.
- 200E** Where the activity, interest or relationship that would impair independence is not terminated by the effective date of the merger or acquisition, Rule 204.4(40)(b) describes the circumstances in which the member or firm may perform or continue with the audit or review engagement, including a requirement that the member or firm apply an appropriate measure or measures, as discussed with the audit committee. Examples of such a measure or measures are:
- having another public accountant review the audit or review or any relevant non-assurance work as appropriate;
 - engaging another firm to evaluate the results of any relevant non- assurance service or to re-perform any relevant non-assurance service to the extent necessary to enable it to take responsibility for the service; and
 - having another professional accountant, who is not a member of the firm performing the audit or review engagement, perform a review that is equivalent to an engagement quality control review.
- 200F** Rule 204.4(40)(c) provides that even if all of the other requirements of the rule are met, where an activity, interest or relationship creates such a significant ongoing threat to independence that compliance with paragraphs 204.4(40)(a) and (b) will still not reduce the threat to an acceptable level, the member or firm is required to resign from the particular audit or review engagement. In determining whether the activity, interest or relationship continues to create such a significant threat that the member or firm would be required to resign, consideration should be given to:
- (a) the nature and significance of the activity, interest or relationship;
 - (b) the extent, if any, to which the activity, interest or relationship continues to affect the financial statements subject to audit or review by the member or firm;
 - (c) the nature and significance of the new relationship with the other entity, for example, whether that other entity becomes a parent, a subsidiary or the client itself; and
 - (d) the adequacy of the actions taken, as described in Rule 204.4(40)(b), to address the activity, interest or relationship.

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In addition, members and firms are reminded of the requirement pursuant to Rule 202.2 to perform professional services with an objective state of mind.

200G Members and firms are also required by Rule 204.5(f) to document:

- (a) a description of the activity, interest or relationship that will not be terminated by the effective date of the merger or acquisition and the reasons why it will not be terminated;
- (b) the results of the discussion with the audit committee and measures applied to address the threat created by any such activity, interest or relationship; and
- (c) the rationale to support the decision of the member or firm.

COUNCIL INTERPRETATION 204.76 **FIRMS TO ENSURE COMPLIANCE BY PARTNERS AND PROFESSIONAL EMPLOYEES**

- 1 Members of the firm include all those persons who are associated with the firm in carrying out its activities. Members of the firm, including employees, who are not subject to the Institute's Rules of Professional Conduct could have an interest or relationship or provide a service that would result in the firm being prohibited from performing a particular engagement. Rule 204.76 requires a member who is a partner or proprietor of a firm to ensure that the firm and all members of the firm, including those who are not members of the Institute, do not have a relationship or interest, do not perform a service and remain free of any influence that would preclude the firm from performing the engagement pursuant to Rules 204.1, 204.32, 204.4 or 204.87.

COUNCIL INTERPRETATION 204.87 **INSOLVENCY ENGAGEMENTS** **Member acting as trustee under the Bankruptcy and Insolvency Act, or as liquidator, receiver or receiver/manager.**

- 1 Rule 204.87 deals with objectivity and independence in insolvency practice. This interpretation sets out how, in Council's opinion, a reasonable observer might be expected to view certain situations related to insolvency practice.
- 2 A firm and a member, or member of the firm, and their respective immediate families, should not acquire directly or indirectly in any manner whatsoever any assets under the administration of the member or firm, provided that any of the foregoing may acquire assets from a retail operation under administration of the member or firm where those assets are available to the general public for sale and that no special treatment or preference over and above that granted to the public is offered to or accepted by the firm, the member or the member of the firm and their respective immediate families.
- 3 A member or firm should avoid being placed in a position of conflict of interest and, in keeping with this principle, should not accept any appointment:
 - (a) which is prohibited by law, or
 - (b) as a receiver, receiver-manager, agent for a secured creditor, or liquidator, or any appointment under the Bankruptcy and Insolvency Act, except as an inspector, in respect of any debtor, where the member or firm is, or at any time during the two preceding years was:

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- (i) a director or officer of the debtor;
- (ii) an employer or employee of the debtor or of a director or officer of the debtor;
- (iii) related to the debtor or to any director or officer of the debtor; or
- (iv) the auditor, accountant or legal counsel, or a partner or an employee of the auditor, accountant or legal counsel of the debtor.

For purposes of this Interpretation the term "accountant" means any member or firm who has performed a review engagement with respect to the financial statements of the debtor in accordance with the *CICA Handbook – Assurance*.

- 4 Where a conflict of interest may exist, or may appear to exist, a member or a firm should make full disclosure to, and obtain the written consent of, all interested parties and, in keeping with this principle, should not accept any appointment:
- (a) as trustee under the Bankruptcy and Insolvency Act where the member or firm has already accepted an appointment as receiver, receiver-manager, agent of a secured creditor, liquidator, trustee under a trust indenture issued by the bankrupt corporation or by any corporation related to the bankrupt corporation, or on behalf of any person related to the bankrupt without having first made disclosure of such prior appointment. The member or firm should inform the creditors of the bankrupt of the prior appointment as soon as reasonably possible;
 - (b) as receiver, receiver-manager, agent for a secured creditor or on behalf of any person related to the bankrupt where the member or firm has already accepted an appointment as trustee under the Bankruptcy and Insolvency Act without first obtaining the permission of the inspectors of the bankrupt estate. Where inspectors have not been appointed at the time that the second appointment is to be taken, the member or firm should obtain the approval of the creditors of the bankrupt of having taken the second appointment as soon as reasonably possible; and if the second appointment is taken before obtaining the approval of the creditors, it should be taken subject to their approval;
 - (c) as receiver, receiver-manager, agent for a secured creditor or trustee under the Bankruptcy and Insolvency Act in respect of any corporation where the member or firm is, or at any time during the two-year period commencing at the date of the last audit report or the last review engagement report was, the trustee (or related to such trustee) under a trust indenture issued by such corporation or by any corporation related to such corporation without first obtaining the permission of the creditors secured under such trust indenture. Upon the acceptance of any such appointment as trustee under the Bankruptcy and Insolvency Act, the member or firm should inform the creditors of the bankrupt corporation of the prior appointment as (or relationship to) the trustee under a trust indenture issued by the bankrupt corporation or by any corporation related to the bankrupt corporation as soon as reasonably possible;
 - (d) as receiver, receiver-manager, agent for a secured creditor, liquidator of an insolvent company under the Winding-Up and Restructuring Act, or trustee under the Bankruptcy and Insolvency Act in respect of any corporation where the member or firm is related to an officer or director of such corporation; or
 - (e) as receiver, receiver-manager, agent for a secured creditor, or trustee under the Bankruptcy and Insolvency Act in respect of any person or corporation where the member or firm is a creditor, or an officer or director of any corporation that is a

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creditor, of such person or corporation unless the relationship is sufficiently remote that the member or firm can act having independence in fact and appearance.

- 5 For purposes of paragraphs 3 and 4, persons are related to each other if they are defined as such under Section 4 of the Bankruptcy and Insolvency Act.
- 6 A member or firm engaged in insolvency practice should ensure there are no relationships with retired partners which may be seen to impair the member's or firm's independence. Refer to paragraph 29 of the interpretations in respect of Rules 204.1 to 204.76.

COUNCIL INTERPRETATION 204.98 INDEPENDENCE - DISCLOSURE OF IMPAIRMENT OF INDEPENDENCE Professional services, other than assurance or specified auditing procedures and insolvency engagements

- 1 Members and firms who provide a professional service which does not require the member or firm to be independent are required by Rule 204.98 to disclose any activity, interest or relationship which, in respect of the professional service, would be seen by a reasonable observer to impair the member's or firm's independence. Members and firms should refer to Rules 204.1 to 204.87 and the related Council Interpretations when determining whether they must be independent and would appear to be independent with respect to particular engagements.
- 2 Such disclosure is required whether or not any written report or other communication is provided and should indicate the nature of the activity or relationship and the nature and extent of the interest. Any written communication concerning or accompanying financial statements or financial or other information must include such disclosure.
- 3 Independence is not required for compilation engagements. Where the provider of the compilation service may be seen to be lacking independence, the disclosure requirement of Rule 204.98 applies.
- 4 For the purposes of Rule 204.98 the preparation of accounting records or journal entries in connection with a compilation engagement is not an activity that requires disclosure in the Notice to Reader unless such preparation involves complex transactions as contemplated by paragraph 143 of the Council Interpretations to Rule 204.1 to 204.76.
- 5 Tax return services may require disclosure in respect of some of the information filed with the return. If the return is simply the assembling and reporting of information provided by the taxpayer, then the member or firm involved has simply processed that information and disclosure should not be necessary.
- 6 Members and firms are cautioned that disclosure under Rule 204.98 does not relieve them from their obligation to comply with the rules of professional conduct and in particular Rules 201, 202, 205 and 206.