ACCA audit monitoring reviews
Ethical issues in audit

This quarter we are focusing specifically on ethical issues in audit engagements.

FRC's Revised Ethical Standard 2024 and IAASA's Ethical Standard for Auditors (Ireland 2020) set out the overarching principles of integrity, objectivity and independence, together with supporting ethical provisions[1], to be applied during audit engagements (FRC and IAASA) and other public interest assurance engagements (FRC only)[2].

THE 'THIRD PARTY TEST'

Both FRC and IAASA require that firms measure their compliance with the ethical principles by considering the perspective of an objective, reasonable and informed third party.

Objective	The imagined third party should be someone who is not influenced by personal feelings or opinions. They should only consider the facts of the matter. They should not be influenced by matters such as the urgency to complete the audit meaning that it would be difficult to find another auditor, the firm being keen to maintain good relationship with the client or the difficulties the firm might have in applying stronger safeguards.
Reasonable	The imagined third party should be someone who is able to consider the matter fairly and take a moderate approach.
Informed	The imagined third party should be someone who is informed about the respective roles and responsibilities of an auditor, those charged with governance and management of an entity and is not another practitioner.[3]

When applying the 'Third Party Test' it might be useful to consider a situation where a non-director shareholder identifies a potential problem with the financial statements after the audit report has been signed. Would you, as a firm, be confident that the shareholder, if behaving reasonably, would accept that the problem was not caused or exacerbated by compromises to the firm's and the audit team's independence?

In 2024, FRC produced guidance on the 'third party test' after noting that "firms have struggled to operationalise this test, and in particular have found it difficult to find an appropriate mechanism to identify and prioritise the non-practitioner perspective.[4]

IDENTIFYING THREATS TO INDEPENDENCE

The firm should ensure that it makes it easy for engagement partners and audit team members to identify threats to independence as early as possible.

While most firms require that staff members complete Fitness and Propriety forms on an annual basis, the results of these forms are not always shared or reviewed at the commencement of an audit engagement. Firms should ensure that the information on the forms relating to ethical threats is collated and made available to the audit teams.

Firms should also ensure that records of other matters concerning ethical threats which are not specific to any staff member are recorded and easily available. This may include the length of time that team members have been involved in audit work for each client and the type of non-audit services provided by the firm and associated fees raised.

1 FRC Revised Ethical Standard 2024 para 19 and IAASA Ethical Standard for Auditors (Ireland) 2020 para 17
2 FRC Revised Ethical Standard 2024 para 11 and IAASA Ethical Standard for Auditors (Ireland) 2020 para 11
3 FRC Revised Ethical Standard 2024 para 114 and IAASA Ethical Standard for Auditors (Ireland 2020) para 111
4 FRC Guidance – the objective, reasonable and informed third party test Ethical Guidance

COMMON ISSUES

During ACCA's audit monitoring reviews, breaches of independence are regularly identified. This is not intended to cover all ethical requirements and does not consider matters specific to public interest entities, but instead to highlight common issues identified by the Senior Compliance Officers during monitoring reviews.

SELF REVIEW THREAT

Deficiencies identified

Firms regularly aim to justify why no self review threats exist when the firm carries out non-audit work, often justified because the firm considers the accounts preparation work to be "mechanical"

A better approach

Firms should recognise that the accounts preparation work (and often corporation tax computations) are unlikely to be purely mechanical. Where the firm prepares the statutory accounts, the firm's work is likely to include calculating the cash flow statement, deciding of the wording for accounting policies and calculating disclosures such as related party transactions.

Often, firms have already separated the preparations of the tax computation and the statutory accounts from the audit work but fail to record this when considering potential threats to independence and the safeguards applied.

Firms should consider the level of complexity of the non-audit services they are providing. The more complex the work, the stronger the safeguards should be to guard against the self review threat. If the firm has concluded that they will separate the non-audit services from the audit services, they should ensure that the person carrying out the non-audit services has the experience and expertise to do so. They should not rely on the audit team identifying and correcting errors during the audit and all non-audit journals and corrections should be made prior to the commencement of the audit.

During the audit, firms should ensure that the non-audit work is tested by the audit team and that this review is clearly documented. Where misstatements are identified, they should be clearly recorded, it should be clear how the error was identified and the audit evidence to support the error should be clear.

MANAGEMENT THREAT

Deficiencies identified

Firms often fail to identify the existence of a management threat arising from non-audit services, even when a self review threat is identified for the same non-audit work. The directors of a company are responsible for preparing statutory accounts, preparing tax returns and maintaining the books and records of a company. If a firm takes over any of these roles, they are carrying out management duties on behalf of the client.

Where a firm has identified a management threat and notes that they are relying on informed management as a safeguard, firms often fail to consider whether the director recorded as being informed management can be relied on for that purpose. The firms are normally correct in identifying the individual as being part of the company's management who has the appropriate authority, however they do not consider whether the individual has the capability to take on that role.

A better approach

Firms should ensure that they consider whether they are carrying out duties that are the responsibility of the client's management. If they are, consider whether the work can be approved by informed management.

Firms should also consider whether the individual identified as being informed management is capable of the role. This might be straightforward where the management threat relates to less complex work, but may require more consideration where the firm is carrying out complex work for the client and the expertise of the individual identified as being informed management relates to the activities of the client, rather than accountancy or tax.

SELF INTEREST THREAT

Deficiencies identified

Firms rarely consider whether the fees generated from non-audit services exceed audit fees and, therefore, cause a self interest threat.

A less common deficiency, but potentially more significant, arises when firms don't consider the level of fees generated by a client or group compared to the total fee income of the firm, or fee income for the part of the firm used to calculate profit share for the engagement partner. Firms sometimes incorrectly consider the "recurring fee" element of this requirement to mean that it is only when this situation occurs for a second time.

A better approach

Firms should always calculate the audit fees generated by a client or group compared to the non-audit fees generated by the same client or group. Where the non-audit fees exceed the audit fees, the firm should identify that a self interest threat exists, because the firm may be tempted to not report an misstatement identified during the audit work if it casts doubt on the quality of the non-audit work carried out by the firm and risk the firm losing the larger non-audit fees. In this situation, the fees should be discussed with the ethics partner of the firm. It should be considered whether the non-audit fees are recurring and substantial and whether an objective, reasonable and informed third party would be concerned at the effect that such services would have on the integrity, objectivity and independence of the firm or the audit team. Safeguards should be applied with consideration that all partners of the firm are likely to be impacted if the non-audit fees were lost.

Firms must ensure that the total recurring fees receivable from a company or group do not exceed 15% of the firm's total fee income, or fee income for the part of the firm used to calculate profit share for the engagement partner. A recurring fee is a fee for services that will be provided more than once. For example, audit work and preparation of statutory accounts will be carried out on an annual basis, therefore they are recurring by nature – they do not need to have recurred for the independence threat to exist.

Where recurring fees for a company or group exceed 15% of the firm's total fee income, or fee income for the part of the firm used to calculate profit share for the engagement partner, the firm must not carry out the audit. It is good practice to ensure that the fee level for clients is reviewed on a regular basis so that this is identified in enough time for the client to engage another auditor.

Where recurring fees for a company or group exceed 10% of the firm's total fee income, or fee income for the part of the firm used to calculate profit share for the engagement partner, the firm must ensure that the ethics partner and the client's directors are informed of the self interest threat. The firm must consider whether sufficient safeguards can be applied to ensure that the third party test can be met. Safeguards should be applied with consideration that all partners of the firm are likely to be impacted by the level of fees.

In addition to considering the total fees generated by a company or group as a proportion of total income, the firm should also consider whether 15% or more of their fees for audit clients are generated by referrals from a non-audit registered firm. This would indicate that the firm would be considered not to be suitably controlled by audit qualified individuals and therefore the firm would not be eligible to hold an audit certificate. Further information regarding eligibility can be found in our March 2025 article.

FAMILIARITY THREAT

Deficiencies identified

Firms often delay applying safeguards to address the long association threat arising. This may because they have realised too late that they have acted for ten years or because they don't believe that their integrity, objectivity or independence is compromised from their continued involvement with the assignment and either do not document their reasoning robustly enough or appropriately apply the third party test.

Firms sometimes only consider familiarity with directors of the client and ignore familiarity with the client's staff or with the new directors in their earlier roles.

As discussed in our previous articles discussing root causes, overfamiliarity with the assignment is always one of the most common root causes identified by firms when preparing their action plans as part of an audit monitoring review.

A better approach

Firms should maintain a record of the number of years that each engagement partner and audit team member has been involved in the audits carried out by the firm. This record should be reviewed on a regular basis so that the firm has time to implement suitable safeguards prior to the commencement of the next audit. Ideally, firms would identify the need to implement safeguards or to resign from the assignment as the ninth year is being completed.

INTIMIDATION THREAT AND ADVOCACY THREATS

Deficiencies identified

While deficiencies relating to intimidation and advocacy threats are less commonly identified by Senior Compliance Officers, firms should ensure that they have a good understanding of how these threats could arise.

Advocacy threats occur where a firm is making arguments on behalf of a client to support a position taken by the client's management. In the case of an advocacy threat, it is unlikely that safeguards could be applied to allow the firm to continue acting as the client's auditor.

Intimidation threats occur where the firm or a member of the audit team is, or could be, influenced by fear or threat. This can cover:

- physical threats and aggression
- a firm being concerned that a loan or overdue fee would not be paid by the client if a modified audit opinion is issued by the firm
- family relationships between employees or directors of the firm and employees or directors of the client
- actual or potential litigation.

In many cases it would not be possible to safeguard against intimation threats, although it may be possible to exclude family members from the audit team to safeguard against intimation threats arising from family relationships, although this would be more difficult if the family member is senior in the firm.

A better approach

For firms monitored by ACCA, these threats occur much less commonly than other threats to independence. This means that firms might not be as experienced at identifying them and so they could be missed. It is important that all audit team members are aware of the different ways in which an auditor's integrity, objectivity or independence could be compromised so that they are able to identify these threats in all situations.

Key points

- Firms should consider all possible compromises to integrity, objectivity or independence from the perspective of a third party who is objective, reasonable and informed – perhaps a shareholder who understands the roles and responsibilities of an auditor
- Firms should be proactive in identifying possible compromises to integrity, objectivity or independence to allow as much time as possible to implement safeguards or to allow the client to engage a different auditor, if deemed necessary
- Firms should ensure that all staff and directors involved in audit work are aware of the different ways in which compromises to integrity, objectivity or independence could occur and ensure that they have access to the information that would allow them to identify the existence of any threats.

REPORTING BREACHES TO ACCA

The Ethical Standard requires the reporting of all breaches to the relevant RAB on at least an annual basis. An example report to ACCA would look like:

Firms headed paper

Report to ACCA

For the attention of the Head of Compliance and Authorisation, ACCA

By email to: regulationoperations@accaglobal.com

Firm name: Name
Ethics Partner: Name
Period covered: 1 Jan 2025 to 31 December 2025

For the above period this firm reports in accordance with the Ethical Standard for Auditors the breaches as set out in the table attached.

Signed Ethics Partner

ABC Chartered Certified Accountants

The ACCA Regulation team present a series of quarterly webinars designed to support practitioners in the UK and Ireland. The core focus of these sessions will be an overview by the audit compliance team of the most recent quarterly article. In addition, we will be inviting speakers from other teams to share their current activities.

In the November session, a member of the rule compliance team and our renewals team will provide an update on their ongoing work.

Please register for the 12 November 2025 12pm – 1pm webinar and we'll look forward to speaking with you then.