

## AUDIT PRACTICE BULLETIN NO. 2 OF 2013

### AUDITOR INDEPENDENCE – SERVING AS AN OFFICER OR DIRECTOR ON THE BOARD OF ASSURANCE CLIENTS

10 APRIL 2013

#### INTRODUCTION

1. Auditor independence is a critical foundation of audit quality and public confidence in audit reports. In Singapore, the independence requirements applicable to public accountants and public accounting entities performing assurance engagements can be found in section 290 of the Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities (the Code) which is included under the Fourth Schedule of the Accountants (Public Accountants) Rules<sup>1</sup>.
2. Section 290 of the Code establishes the conceptual framework to independence that sets out the fundamental independence principles and provides guidance to public accountants on how to apply these principles. It places an expectation on public accountants to proactively identify and eliminate potential threats to independence. The section also includes some examples of how the conceptual approach to independence is to be applied to specific circumstances and relationships. The examples discuss threats to independence that may be created by specific circumstances and relationships.
3. Apart from the Code, accounting firms should also take note of the requirements under section 10 of the Companies Act, Cap. 50 when accepting appointments as auditors.
4. This article aims to highlight some of the non-compliance with the independence requirements which ACRA has dealt with through the complaints and discipline process and focuses particularly on the topic of **Serving as an Officer or Director on the Board of Assurance Clients**<sup>2</sup>.

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<sup>1</sup> The Accountants (Public Accountants) Rules is available for download at:  
<https://sso.agc.gov.sg/Act/AA2004?ViewType=SI>

<sup>2</sup> Public accountants can also refer to ACRA's Audit Practice Bulletin (APB) No. 2 of 2012 *Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements (Part 2)*, issued on 18 September 2012, for points of consideration when establishing policies and procedures to ensure compliance with auditor independence and other ethical requirements.

## REQUIREMENTS UNDER THE CODE

5. Paragraph 290.149 of the Code states that *“if a public accountant, partner or employee of the firm serves as an officer or as a director on the board of an assurance client the selfreview and self-interest threats created would be so significant no safeguard could reduce the threats to an acceptable level. In the case of a financial statement audit engagement, if a public accountant, partner or employee of a network firm were to serve as an officer or as a director on the board of the audit client the threats created would be so significant no safeguard could reduce the threats to an acceptable level. Consequently, if such an individual were to accept such a position the only course of action is to refuse to perform, or to withdraw from the assurance engagement.”* (Emphasis added)
6. Paragraph 290.151 of the Code states that *“if a public accountant, partner or employee of the firm or a network firm<sup>3</sup> serves as company secretary for a financial statement audit client the self-review and advocacy threats created would generally be so significant, no safeguard could reduce the threat to an acceptable level.”* (Emphasis added)
7. Whilst the provision of routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters may be permitted under paragraph 290.152 of the Code<sup>4</sup>, firms need to ensure that client management makes all relevant decisions as required by the Code.

## REQUIREMENTS UNDER THE COMPANIES ACT

8. Under section 10(5) of the Companies Act, an accounting firm *“shall not knowingly consent to be appointed, and shall not knowingly act, as auditor for any company”* if any partner of the firm, whether he or she is a public accountant, is an officer<sup>5</sup> of the company. For the purpose of section 10(5), read with section 10(1)(c)(i) of the Companies Act, the reference to an *“officer of a company”* includes an officer of a company that is deemed to be related to the company by virtue of section 6 of the Companies Act<sup>6</sup>.

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<sup>3</sup> The Code defines a network firm as *“a firm or entity that belongs to a network”*. A network is *“a larger structure (a) that is aimed at co-operation, and (b) that is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.”*

<sup>4</sup> Paragraph 290.152 of the Code states that *“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.”*

<sup>5</sup> Section 4 of the Companies Act defines officer as *“in relation to a corporation, includes (a) any director or secretary of the corporation or a person employed in an executive capacity by the corporation...”*

<sup>6</sup> Section 6 of the Companies Act states that *“Where a corporation — (a) is the holding company of another corporation; (b) is a subsidiary of another corporation; or (c) is a subsidiary of the holding company of another*

## PAST CASES OF BREACH OF INDEPENDENCE

9. ACRA had encountered several instances where independence requirements were breached and these include:

- (a) Firms acting as auditors of clients when employees of their network firms were appointed as director or secretary of the assurance clients pursuant to section 171 of the Companies Act. This is in breach of paragraphs 290.149 and 290.151 of the Code. In one case, the firm had regarded as possible safeguard, the use of clauses in the network firm's engagement letter which state that the employee is acting as a "named" secretary and would not be involved in the assurance client's business, management and administrative functions. This is unacceptable as such clauses do not mitigate or absolve the personnel's responsibility as a company secretary under the Companies Act. Indeed, both paragraphs 290.149 and 290.151 have provided that no safeguard could reduce the threats created when a public accountant, partner or employee of the firm or a network firm serves as an officer or company secretary for a financial statement audit client.
- (b) Public accountants undertaking audits of companies in which the spouse was a director or secretary of the company. This is in breach of paragraph 290.136<sup>7</sup> of the Code as it creates a threat to independence which can only be reduced to an acceptable level by removing the individual (in this case, the public accountants) from the assurance team performing the engagement.
- (c) Firms acting as auditors for client companies when partners of the firms served as directors in the *related companies* of the client companies. This contravenes section 10(5) of the Companies Act which prohibits the firm from accepting appointment as auditor when any partner of the firm is an officer of the company which includes "deemed" officer i.e. officer of a related company<sup>8</sup>. In one case, the breach had occurred as the partner was unaware that the company in which he served as director was related to an audit client as the firm had relied on an incomplete list of related companies provided by the client to carry out the independence checks. To avoid the breach, firms should consider the following:
  - (i) Establish policies and procedures governing the partners' acceptance of appointment as directors of companies;

*corporation, that first-mentioned corporation and that other corporation shall for the purposes of this Act be deemed to be related to each other."*

<sup>7</sup> Classified under "Family and Personal Relationships" in the Code.

<sup>8</sup> As set out at paragraph 8 of this APB, for the purpose of section 10(5), read with section 10(1)(c)(i) of the Companies Act, the reference to an “*officer of a company*” includes an officer of a company that is deemed to be related to the company by virtue of section 6 of the Companies Act.

- (ii) Require confirmation from the partners that they have not undertaken any directorships which would create a conflict with the firm’s appointment as auditor of a company. This could be part of the annual independence declaration which firms may have in place for all engagement team members to re-affirm their independence with respect to the firm’s audit engagements;
- (iii) Institute internal monitoring mechanism such as conducting periodic reviews of all directorships of the partners against the firm’s audit client list to determine if any breach has occurred and taking appropriate followup actions in the event of noted lapses and misdeclaration on the part of the partners; and
- (iv) Ensure as part of client acceptance and continuance process, that a complete list of related companies of the audit clients is obtained and reviewed for appointment of partner as directors of the related companies.

10. For the above breaches, ACRA has issued stern warnings to the public accountants and accounting entities concerned to avoid circumstances that may lead to doubts regarding their independence as auditors and that any further breaches in future will result in more severe regulatory actions being taken against them.

## CONCLUSION

11. ACRA would like to remind all public accountants and accounting entities of the need to strictly observe the requirements of the Code and the Companies Act as any noncompliance could subject the public accountants and accounting entities concerned to disciplinary proceedings under Part IV of the Accountants Act and/or prosecution under the Companies Act.

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Note: Please note that the contents of the Audit Practice Bulletin are provided for the guidance of public accountants to supplement prescribed professional standards, and include criteria that ACRA considers in evaluating the work of public accountants. They are not rules of ACRA and are not intended to serve as a substitute for the relevant auditing standards. Public accountants must observe, maintain and apply the prescribed professional standards, methods, procedures and other requirements in carrying out the audits of financial statements.