

TECHNOLOGY PRODUCTS LICENSED TO CLIENTS: INDEPENDENCE CONSIDERATIONS FOR END USERS

Introduction

It is increasingly common for professional services firms to licence software or other technology to clients who then sell or licence the software or other technology, either as is, or on a tailored basis, to third parties. The many different ways in which such transactions are structured and sometimes linked, mean that in addition to the independence issues in relation to the client to which the software or other technology is sold, careful consideration needs to be given to independence issues in situations in which the firm is considering appointment or re-appointment as the auditor of the third party.

Definitions

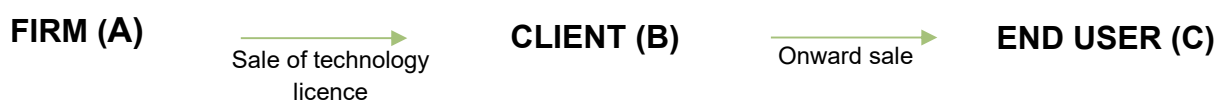
Client: an entity with whom a professional services firm (Firm) subject to auditor independence regulations has contracts for the provision of technology licences, to whom the Firm owes a duty of care. A Client uses technology licences provided by the Firm to provide services to its own Users – ‘End Users’.

End User: A User of a Client. The Firm does not have a contractual relationship with the End User and does not owe a duty of care to the End User.

Purpose

The purpose is to promote consistency among firms and audit regulators in the application of independence and other ethical principles, to the provision of technology services that are built for and/or used by Clients, such as fund administrators, to deliver services to End Users, with reference to the commercial substance of transactions and relationships over their legal form. Many situations will arise in which the determination of independence with regard to the Firm and End User is not straightforward.

When considering appointment or re-appointment as auditor of the End User the Firm should focus on understanding the circumstances in which a relationship between the Firm and the End User exists such that the Firm needs to ‘look through’ the Client to the End User to determine whether there are any independence considerations to be taken into account or monitored.



Different criteria intended to help determine whether in substance there is a relationship with the End User that must be taken into account for independence purposes, even though there is no legal relationship between the Firm and the End User, is set out in a matrix below.

For each criterion, factors to be considered are provided under the headings of ‘positive’, ‘neutral’ and ‘negative’. All relevant factors should be aggregated when determining whether there is an independence issue for the Firm to address in relation to the End User.

‘Positive’ factors **suggest that it is unlikely that there is a need** for the Firm to look through the Client to the End User when considering independence issues in relation to the End User.

‘Neutral’ factors **suggest that there may be a need** for the Firm to look through the Client to the End User when considering independence issues in relation to the End User.

'Negative' factors **suggest that there is a need** for the Firm to look through the Client to the End User when considering independence issues in relation to the End User.

While no weighting is applied to each criterion, because no criterion will be generally indicative in isolation, **the negative factors highlighted in red are indicative of a threat to independence that cannot be safeguarded for any audited entity.** This means that for those End Users, the Firm cannot act as external auditor.

For Public Interest Entities (PIEs) and Other Entities of Public Interest (OEPIs), the prohibition on indirect provision of services in Appendix B of the FRC ES 2019 also needs to be considered. Consideration of independence requirements under the United States Securities Exchange Commission (SEC) have not been taken into account.

Impact of technology solution on End User

Criterion	Positive	Neutral	Negative
Impact on financial statements (self-review)	End result, or purpose, of the technology solution has no impact on the financial statements of the End User.	End result, or purpose, of the technology solution has an immaterial impact on the financial statements* of the End User.	End result, or purpose, of the technology solution has a material impact on the financial statements of the End User
Control environment (self-review)	End result, or purpose, of the technology solution has no impact on an internal control relating to the preparation of financial information of the End User. The solution does not provide ongoing monitoring.	End result, or purpose, of the technology solution has an immaterial impact on an internal control relating to the preparation of financial information of the End User**	End result, or purpose, of the technology solution has a material impact on an internal control relating to the preparation of financial information of the End User. The solution provides ongoing monitoring which in turn poses a management threat
Importance to End User's operations/ reliance on system by End User (management)	End result, or purpose, of the technology solution has no impact on the End User's operations/is one of many inputs to management's decision making.	End result, or purpose, of the technology solution is no more than incidental to the End User's operations/is one of several inputs to management's decision making.	End result, or purpose, of the technology solution is integral to the End User's operations/a key input to management's decision making

Note:

Red box: threat likely to be too significant to be safeguarded for any audited entity, therefore it is necessary to look through to the end customer

* Where end customer may be a PIE/OEPI the indirect provision of a prohibited service (e.g., bookkeeping) is likely to have arisen

** Where end customer may be a PIE/OEPI consider whether the indirect provision of a prohibited service (i.e., design and implementation of internal controls) is likely to have arisen

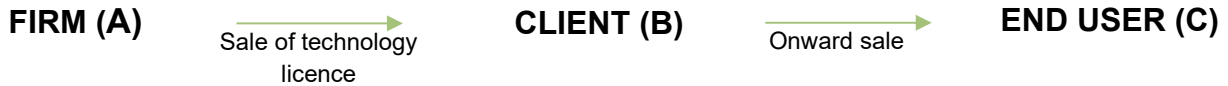
Relationship between the Firm and End Users (third party test)

Criterion	Positive	Neutral	Negative
Hosting	Hosting environment owned and maintained by Client either directly or contracted with third party.		Hosting environment owned and maintained by the Firm. The Firm either hosts the solution or holds the contract with another third party which is hosting the solution for the direct Client.
Ongoing involvement/maintenance required	No residual obligations in relation to the technology solution.	Obligation to provide regular technology updates (e.g., security patches, bug-fixes) independent of the content or subject matter of the technology solution. "Keep the lights on" updates.	Obligation to provide functional updates and/or content-related information (e.g., annual updates for changes to tax rates). Where such updates are specific to End Users (rather than generic to the solution as a whole) this increases the negative weighting of this factor.
Configuration	Technology needs configuring for specific End Users: done by Client.	Technology does not need configuring for End Users or any configuration is generic.	Technology needs configuring for specific End Users: done by the Firm.
Access by the End User	No access to the solution. End User only receives output from the tool from the Client.	Passive access e.g., read only.	Active access e.g., including editing rights.
Benefit to the End User	None.	The value provided by the tool would be minimal.	The primary purpose of the tool is to support the Client's delivery to its End Users.
Direct interaction with the End Users	Firm's personnel do not directly interact with End Users.		Firm's personnel directly interact with End Users.
Basis of fee payable to the Firm by the Client	Annual or one-off pre-determined fixed fee not dependent on sales to End Users.	Pre-agreed 'volume-based' fee, or including phased or tiered approaches dependent on other internal metrics.	Specific fee negotiated at point of sale for each End User of the Client (consider also potential self-interest threat). Revenue sharing and/or 1:1 correlation between the Firm's fees from the direct Client and the End Users.

Criterion	Positive	Neutral	Negative
Visibility of provider to End User	Client branded solution (including any external reports created).	Firm branded technology solution, where the branding is not visible on reports issued to End Users i.e., End Users do not see Firm branding.	Firm branded solution visible to Client and End Users (including any external reports created).
	Firm's involvement is invisible to the End Users.	Firm's involvement may be visible to End Users, but it is not a factor when End Users are determining a service provider.	Firm's involvement in the technology solution is widely known and it becomes a selling point for the Client to market their own services.
Nature of solution	Solution that is designed to be sold to a wide variety of Clients with similar use-cases ("generic").		One-off, build of a technology solution to a Client's specific requirements ('bespoke').
Number of providers	There are many third-party providers of similar technology solutions that the Client could purchase.		There is only one provider of a specific technology solution, with no equivalents in the market – i.e., clear that the Firm is involved in the provision of the solution.
Significance to service	The technology provides an immaterial or incidental element of the Client's overall service offering.		The technology solution is a critical or primary element of the Client's overall service Offering.
Intellectual Property	Technology solution contains only intellectual property of the Client (or intellectual property that is acquired by the Client).	Technology solution contains only open-source information, or intellectual property that does not need protecting.	Technology solution contains intellectual property of the Firm, that needs to be protected.

APPENDIX: Examples

Example 1



- A tax technology product tracks overseas travel and calculates overseas tax earned. Firm A sells this product to non-audit client B. Firm A's branding is not used in the product and it is sold for a one-off fee to Client B that has the right to sell it to its Users.
- Client B sells the product to End User C. C's financial statements are not materially impacted by the product and C does not know where the product originates. There is no contract or commercial relationship between Firm A and End User C.
- The product is generic and not tailored to the needs of the End User (C).

In this example, firm A has no financial interest in the onward sales made by Client B. It makes no difference to Firm A whether firm Client B makes any sales of the product. The anonymity of the product means that Firm A has no other interest in sales by Client B of the product.

The substance of the transaction between Firm A and Client B, and the absence of any relationship between Firm A and End User C, means that Firm A has no relationship with End User C that might be significant for the purposes of independence evaluations, and of itself, the arrangement would not be a bar to Firm A acting as End-User C's auditor.

Example 2



A tax technology product tracks overseas travel and calculates overseas tax earned. Firm A sells this product to non-audit client B. However, in this example the product is designed to address the specific needs and circumstances of End User C, and the product will only be sold to End User C, and to no other third parties.

In this example, despite the fact that firm A has no contractual interest with End User C, the product has been specifically tailored for End User C and the substance of the transaction strongly suggests that Firm A has a relationship with End User C that might be significant for the purposes of independence evaluations for the purposes of audit.