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Auditor Independence – Threats and Safeguards
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Conceptual Approach to Independence

An auditor is required to be Independent while performing an Audit and/or certain other Assurance services, Independence requires:

Independence of Mind
The state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional scepticism.

Independence in Appearance
The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional scepticism had been compromised.
The use of the word "independence" on its own may create misunderstandings. Standing alone, the word may lead observers to suppose that a person exercising professional judgment ought to be free from all economic, financial and other relationships. This is impossible, as every member of society has relationships with others.

Therefore, the significance of economic, financial and other relationships should also be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

An Auditor who is required to be Independent pursuant to the Statutory/Professional requirements, should consider threats to independence, evaluate the significance of those threats and, if the threats are other than clearly insignificant, identify and apply safeguards to reduce the threats to an acceptable level.

Judgment is needed to determine which safeguards are to be applied. Some safeguards may eliminate the threat while others may reduce the threat to an acceptable level.
The nature of the threats to Independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level differ depending on the characteristics of the individual engagement.

Threats to Independence and Safeguards will vary depending on whether the assurance engagement is an Audit engagement or another type of engagement; and in the case of an assurance engagement that is not an audit engagement, the purpose, subject matter and intended users of the report.

A Firm should, therefore, evaluate the relevant circumstances, the nature of the assurance engagement and the threats to independence in deciding whether it is appropriate to accept or continue an engagement, as well as the nature of the safeguards required and whether a particular individual should be a member of the assurance team.
Audit engagements provide assurance to a wide range of potential users; consequently, in addition to independence of mind, independence in appearance is of particular significance.

Accordingly, for audit clients, the members of the assurance team, the firm and network firms are required to be independent of the audit client.

Similar considerations in the case of assurance engagements provided to non-audit assurance clients require the members of the assurance team and the firm to be independent of the non-audit assurance client. In the case of these engagements, consideration should be given to any threats that the firm has reason to believe may be created by network firm interests and relationships.
Conceptual Approach to Independence

In the case of an assurance report to a non-audit assurance client expressly restricted for use by identified users, the users of the report are considered to be knowledgeable as to the purpose, subject matter and limitations of the report through their participation in establishing the nature and scope of the firm's instructions to deliver the services, including the criteria by which the subject matter are to be evaluated.

This knowledge and enhanced ability of the firm to communicate about safeguards with all users of the report increase the effectiveness of safeguards to independence in appearance.

Further, if the firm had a material financial interest, whether direct or indirect, in the assurance client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level.
Conceptual Approach to Independence

Based on the aforesaid discussion the Independence requirements could be described as follows:

- For assurance engagements provided to an audit client, the members of the assurance team, the firm and network firms are required to be independent of the client;

- For assurance engagements provided to clients that are not audit clients, when the report is not expressly restricted for use by identified users, the members of the assurance team and the firm are required to be independent of the client; and

- For assurance engagements provided to clients that are not audit clients, when the assurance report is expressly restricted for use by identified users, the members of the assurance 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.
Threats to Independence
Threats to Independence

Independence is potentially affected by the threats from:

- Self-interest;
- Self-review;
- Advocacy;
- Familiarity; and
- Intimidation.

These will be discussed in more details.
"Self-Interest Threat" occurs when a firm or a member of the assurance team could benefit from a financial interest in, or other self-interest conflict with, an assurance client. Examples of circumstances that may create this threat include:

- A direct financial interest or material indirect financial interest in an assurance client;
- A loan or guarantee to or from an assurance client or any of its directors or officers;
- Undue dependence on total fees from an assurance client;
- Concern about the possibility of losing the engagement;
- Having a close business relationship with an assurance client;
- Potential employment with an assurance client; and
- Contingent fees relating to assurance engagements.
"Self-Review Threat" occurs when:

1. any product or judgment of a previous assurance engagement or non-assurance engagement needs to be re-evaluated in reaching conclusions on the assurance engagement; or

2. when a member of the assurance team was previously a director or officer of the assurance 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 this threat include:

- A member of the assurance team being, or having recently been, a director or officer of the assurance client;
- A member of the assurance 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;
- Performing services for an assurance client that directly affect the subject matter of the assurance engagement; and
- Preparation of original data used to generate financial statements or preparation of other records that are the subject matter of the assurance engagement.
"Advocacy Threat" occurs when a firm, or a member of the assurance team, promotes, or may be perceived to promote, an assurance client's position or opinion to the point that objectivity may, or may be perceived to be, compromised. Such may be the case if a firm or a member of the assurance team were to subordinate their judgment to that of the client.

Examples of circumstances that may create this threat include, but are not limited to:

- Dealing in, or being a promoter of, shares or other securities in an assurance client; and
- Acting as an advocate on behalf of an assurance client in litigation or in resolving disputes with third parties.
"Familiarity Threat" occurs when, by virtue of a close relationship with an assurance client, its directors, officers or employees, a firm or a member of the assurance team becomes too sympathetic to the client's interests.

Examples of circumstances that may create this threat include:

· A member of the assurance team having an immediate family member or close family member who is a director or officer of the assurance client;

· A former partner of the firm being a director, officer of the assurance client or an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement;

· Long association of a senior member of the assurance team with the assurance client; and

· Acceptance of gifts or hospitality, unless the value is clearly insignificant, from the assurance client, its directors, officers or employees.
"Intimidation Threat" occurs when a member of the assurance team may be deterred from acting objectively and exercising professional scepticism by threats, actual or perceived, from the directors, officers or employees of an assurance client.

Examples of circumstances that may create this threat include, but are not limited to:

- Threat of replacement over a disagreement with the application of an accounting principle; and

- Pressure to reduce inappropriately the extent of work performed in order to reduce fees.
Possible Safeguards to Manage Threats to Independence
The firm and members of the assurance team have a responsibility to remain independent. Therefore, when threats are identified, other than those that are clearly insignificant, appropriate safeguards should be identified and applied to eliminate the threats or reduce them to an acceptable level. This decision should be documented.

The nature of the safeguards to be applied will vary depending upon the circumstances. Consideration should always be given to what a reasonable and informed third party having knowledge of all relevant information, including safeguards applied, would reasonably conclude to be unacceptable.

The consideration will be affected by matters such as the significance of the threat, the nature of the assurance engagement, the intended users of the assurance report and the structure of the firm.

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.
Safeguards created by the Profession or Regulation

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

- Educational, training and experience requirements for entry into the profession;
- Continuing education requirements (e.g. CPE);
- Professional standards and monitoring and disciplinary processes (e.g. Code of Professional Ethics, IFAC Handbook);
- External review of a firm's quality control system (e.g. PCAOB Review of the Auditors of SEC Registrants); and
- Legislation governing the Independence requirements of the Audit Firm.
Safeguards within the Client

Safeguards within the assurance client, include:

- When the assurance client's management appoints the firm, persons other than management ratify or approve the appointment;
- The assurance client has competent employees to make managerial decisions;
- Policies and procedures that emphasize the assurance client's commitment to fair financial reporting;
- Internal procedures that ensure objective choices in commissioning non-assurance engagements; and
- A corporate governance structure, such as an audit committee, that provides appropriate oversight and communications regarding a firm's services.

Audit committees can have an important corporate governance role when they are independent of client management and can assist the Board of Directors in satisfying themselves that a firm is independent in carrying out its audit role.
Safeguards within the Firm

Safeguards within the Firm's own systems and procedures may include Firm-wide safeguards such as:

- Firm leadership that stresses the importance of Independence and the expectation that members of assurance teams will act in the public interest;
- Policies and procedures to implement and monitor quality control of assurance engagements;
- Documented Independence policies regarding the identification of threats to independence, the evaluation of the significance of these threats and the application of safeguards to eliminate or reduce the threats;
- Internal policies and procedures to monitor compliance with Firm policies and procedures as they relate to Independence;
- Policies and procedures that will enable the identification of interests or relationships between the Firm or members of the assurance team and assurance clients;
- Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single assurance client;
Safeguards within the Firm (continued)

- Using different partners and teams with separate reporting lines for the provision of non-assurance services to an assurance client;
- Policies and procedures to prohibit individuals who are not members of the assurance team from influencing the outcome of the assurance engagement;
- Timely communication of a firm's policies and procedures, and any changes thereto, to all partners and professional staff, including appropriate training and education thereon;
- Designating a member of senior management as responsible for overseeing the adequate functioning of the safeguarding system;
- Means of advising partners and professional staff of those assurance clients and related entities from which they must be independent;
- A disciplinary mechanism to promote compliance with policies and procedures; and
- Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.
Safeguards within the Firm (continued)

Safeguards within the Firm's own systems and procedures may include engagement specific safeguards such as:

- Involving an additional professional accountant to review the work done or otherwise advise as necessary. This individual could be someone from outside the firm or someone within the firm who was not otherwise associated with the assurance team;
- Consulting a third party, such as a committee of independent directors, a professional regulatory body or another professional accountant;
- Rotation of senior personnel;
- Discussing Independence issues with the Audit Committee or others charged with Governance;
- Policies and procedures to ensure members of the Assurance team do not make, or assume responsibility for, management decisions for the assurance client;
- Removing an individual from the assurance team, when that individual's financial interests or relationships create a threat to independence.
Specific Examples of Threats and Safeguards
Direct Financial Interest

If a firm, or a network firm, has a direct financial interest in an audit client of the firm the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.

If a firm, or a network firm, has a material indirect financial interest in an audit client of the firm a self-interest threat is also created. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.

If other partners, including partners who do not perform assurance engagements, or their immediate family, hold a direct financial interest or a material indirect financial interest in that audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such partners or their immediate family should not hold any such financial interests in such an audit client.
Loans and Guarantees

A loan from, or a guarantee thereof by, an assurance client that is a bank or a similar institution, to the firm would not create a threat to independence provided the loan is made under normal lending procedures, terms and requirements and the loan is immaterial to both the firm and the assurance client.

A loan from, or a guarantee thereof by, an assurance client that is a bank or a similar institution, to a member of the assurance team or their immediate family would not create a threat to independence provided the loan is made under normal lending procedures, terms and requirements. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.

Similarly, deposits made by, or brokerage accounts of, a firm or a member of the assurance team with an assurance client that is a bank, broker or similar institution would not create a threat to independence provided the deposit or account is held under normal commercial terms.
Close Business Relationships

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.

Possible Threats:

- Having a material financial interest in a joint venture with the client or controlling owner, director, officer or other individual who performs senior management functions for that client;
- Arrangements to combine one or more services or products of the firm with one or more serviced or products of the client and to market the package with reference to both parties; and

Safeguards:

- Reducing the magnitude of or eliminating the transaction;
- Removing the individual involved from the engagement team;
- Discussing the issue with the audit committee; or
- Arranging to contract separately with a third party rather than combining services with the assurance client.
Family and Personal Relationships

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 may create a self-interest, familiarity or intimidation threat.

Factors to consider in evaluating threat:

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

Safeguards:

• 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 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.
Employment with an Assurance Client

The independence of a firm or a person on the engagement team may be threatened if a director, officer or employee of the assurance client in a position to exert influence over the subject matter of the assurance engagement has been 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.

Factors to consider in evaluating threat:

• The position the individual has taken at the client and whether the position involves direct or significant influence over the subject matter;
• 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
• The former position of the individual within the engagement team or firm.
**Safeguards:**

The following safeguards are mandatory 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.
Recent Service with an Assurance Client

A self-interest, self-review or familiarity threat may exist when a former officer, director or employee of an assurance client becomes a part of the engagement team for that client.

*Factors to consider in evaluating threat:*

- The position the individual held with the client;
- The length of time since the individual left the client; and
- The role of the individual on the engagement team.

*Safeguards:*

- Removing the particular person from the engagement team;
- 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.
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.

**Factors to consider in evaluating threat:**

- 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.

**Safeguards:**

- Rotation after a pre-defined period, normally no more than seven years;
- Discussing the matter with the audit committee;
- 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; 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.
When the total fees generated from an assurance client represent a significant proportion of the partner’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.

A self-interest threat may also 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.

Safeguards:

- Taking steps to reduce the dependency on the client;
- Having firm policies and procedures to monitor and implement quality control of assurance engagements;
- Discussing the level of outstanding fees with the audit committee;
- Involving another member of the firm who is not part of the engagement team to provide advice or review the work performed.
Pricing

When a firm obtains an assurance engagement at a significantly lower fee level than that charged by the predecessor firm, or quoted by other firms, the self-interest threat created will not be reduced to an acceptable level unless the firm is able to demonstrate that appropriate time and qualified staff are assigned to the task and all applicable assurance standards, guidelines and quality control procedures are being complied with.

Contingent fees

Contingent fees are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed.

A contingent fee charged by a firm in respect of an assurance engagement creates self-interest and advocacy threats that cannot be reduced to an acceptable level by the application of any safeguard. Accordingly, a firm should not enter into any fee arrangement for an assurance engagement under which the amount of the fee is contingent on the result of the assurance work or on items that are the subject matter of the assurance engagement.
Accepting gifts or hospitality from an assurance client may create self-interest and familiarity threats.

When a firm or a member of the assurance team accepts gifts or hospitality, unless the value is clearly insignificant, the threats to independence cannot be reduced to an acceptable level by the application of any safeguard. Consequently, a firm or a member of the assurance team should not accept such gifts or hospitality.
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 the members of the assurance team must be characterized by complete candour and full disclosure regarding all aspects of a client's business operations.

The firm and the client's management may be placed in adversarial positions by litigation, affecting management's willingness to make complete disclosures and the firm may face a self-interest threat.

Once the significance of the threat has been evaluated the following safeguards should be applied;

• Disclosing to the audit committee the extent and nature of the litigation;
• Removing from the engagement team any person involved in the litigation; and
• Involving an additional member of the firm who is not part of the engagement team to review the work done or advise as necessary.
Provision of Non-Assurance Services to an Assurance Client
Provision of Non-Assurance Services

Firms have traditionally provided to their assurance clients a range of non-assurance services that are consistent with their skills and expertise. Assurance clients value the benefits that derive from having these firms, who have a good understanding of the business, bring their knowledge and skill to bear in other areas.

Furthermore, the provision of such non-assurance services will often result in the assurance team obtaining information regarding the assurance client's business and operations that is helpful in relation to the assurance engagement. The greater the knowledge of the assurance client's business, the better the assurance team will understand the assurance client's procedures and controls, and the business and financial risks that it faces.

The provision of non-assurance services may, however, create threats to the independence of the firm or the members of the assurance team, particularly with respect to perceived threats to independence. Consequently, it is necessary to evaluate the significance of any threat created by the provision of such services. In some cases it may be possible to eliminate or reduce the threat created by application of safeguards. In other cases no safeguards are available to reduce the threat to an acceptable level.
Provision of Non-Assurance Services

The following activities would generally create self-interest or self-review threats that are so significant that only avoidance of the activity or refusal to perform the assurance engagement would reduce the threats to an acceptable level:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of the assurance client, or having the authority to do so.
- Determining which recommendation of the firm should be implemented.
- Reporting, in a management role, to those charged with governance.

The following activities may also create self-review or self-interest threats:

- Having custody of an assurance client's assets.
- Supervising assurance client employees in the performance of their normal recurring activities.
- Preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction (for example, purchase orders, payroll time records, and customer orders).
Provision of Non-Assurance Services

The following examples of general safeguards may be appropriate for any non-assurance service.

**General Safeguards:**

- 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 engagement on the independence of the persons on the engagement team and the firm;
Provision of Non-Assurance Services

- Involving a professional 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 work performed by the firm;

- Disclosing to the audit committee the nature of the engagement and extent of fees charged; or

- Arranging that the members of the firm providing the non-assurance service do not participate on the audit engagement team.
Preparation of Accounting Records and Financial Statements

The firm, or a network firm, may provide an audit client that is not a listed entity with accounting and bookkeeping services, including payroll services, of a routine or mechanical nature, provided any self-review threat created is reduced to an acceptable level. Examples of such services include:

- Recording transactions for which the audit client has determined or approved the appropriate account classification;
- Posting coded transactions to the audit client's general ledger;
- Preparing financial statements based on information in the trial balance; and
- Posting audit client approved entries to the trial balance.

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered. Such safeguards might include:
• Making arrangements so such services are not performed by a member of the assurance team;

• Implementing policies and procedures to prohibit the individual providing such services from making any managerial decisions on behalf of the audit client;

• Requiring the source data for the accounting entries to be originated by the audit client;

• Requiring the underlying assumptions to be originated and approved by the audit client;

• Obtaining audit client approval for any proposed journal entries or other changes affecting the financial statements; or

• Posting audit client approved entries to the trial balance.
Audit clients that are listed entities

The provision of accounting and bookkeeping services, including payroll services and the preparation of financial statements or financial information which forms the basis of the financial statements on which the audit report is provided, on behalf of an audit client that is a listed entity, may impair the independence of the firm or network firm, or at least give the appearance of impairing independence.

Accordingly, no safeguard other than the prohibition of such services, except in emergency situations and when the services fall within the statutory audit mandate, could reduce the threat created to an acceptable level. Therefore, a firm or a network firm should not, with the limited exceptions below, provide such services to listed entities which are audit clients.

The provision of accounting and bookkeeping services of a routine or mechanical nature to divisions or subsidiaries of listed audit clients would not be seen as impairing independence with respect to the audit client provided that the services do not involve the exercise of judgment and the divisions or subsidiaries for which the service is provided are collectively immaterial to the audit client.
Emergency situations

The provision of accounting and bookkeeping services to audit clients in emergency or other unusual situations, when it is impractical for the audit client to make other arrangements, would not be considered to pose an unacceptable threat to independence provided:

• The firm, or network firm, does not assume any managerial role or make any managerial decisions;

• The audit client accepts responsibility for the results of the work; and

• Personnel providing the services are not members of the assurance team.
A valuation comprises the making of assumptions with regard to future developments, the application of certain methodologies and techniques, and the combination of both in order to compute a certain value, or range of values, for an asset, a liability or for a business as a whole.

A self-review threat may be created when a firm or network firms performs a valuation for an audit client that is to be incorporated into the client's financial statements.

If the valuation service involves the valuation of matters material to the financial statements and the valuation involves a significant degree of subjectivity, the self-review threat created could not be reduced to an acceptable level by the application of any safeguard. Accordingly, such valuation services should not be provided or, alternatively, the only course of action would be to withdraw from the audit engagement.

Performing valuation services that are neither separately, nor in the aggregate, material to the financial statements, or that do not involve a significant degree of subjectivity, may create a self-review threat that could be reduced to an acceptable level by the application of safeguards. Such safeguards might include:
Valuation Services (cont.)

- 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 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 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.

In determining whether the above safeguards would be effective, consideration should be given to the extent of the audit client's knowledge, experience and ability to evaluate the issues concerned, and the extent of their involvement in determining and approving significant matters of judgment.
The firm may be asked to provide taxation services to an audit client. Taxation services comprise a broad range of services, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes.

A self review or advocacy threat may exist when a member or firm provides taxation services to an audit or review client, however such arrangements are generally not seen to create threats to independence that are not adequately offset by available safeguards.

*Safeguards:*

- Detailed tax laws are consistently applied;
- Internal policies regarding developing tax strategies for clients;
- Policies and procedures to prohibit members of the firm from making management decisions on behalf of the client.
A self-review threat may be created when a firm, provides internal audit services to an audit client. Internal audit services may comprise an extension of the firm's audit service beyond requirements of generally accepted auditing standards, assistance in the performance of a client's internal audit activities or outsourcing of the activities. In evaluating any threats to independence, the nature of the service will need to be considered.

Services involving an extension of the procedures required to conduct an audit in accordance with International Standards on Auditing would not be considered to impair independence with respect to an audit client provided that the firm's personnel do not act or appear to act in a capacity equivalent to a member of audit client management.

When the firm provides assistance in the performance of a client's internal audit activities or undertakes the outsourcing of some of the activities, any self-review threat created may be reduced to an acceptable level by ensuring that there is a clear separation between the management and control of the internal audit by audit client management and the internal audit activities themselves.
Safeguards:

• 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 the co-ordination of 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.
The provision of services by a member, firm or network firm to an audit or review client and involves the design or implementation of financial information technology systems that are, or will be, used to generate information forming part of the client’s financial statements may create a self-review threat.

_Safeguards:_

- 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.
Temporary Staff Assignments

The lending of staff by the Firm, to an Audit client may create a self-review threat when the individual is in a position to influence the preparation of a client’s accounts or financial statements. Such assistance may be given (particularly in emergency situations) but only on the understanding that the personnel will not be involved in

(a) Making management decisions;
(b) Approving or signing agreements or other similar documents; or
(c) Exercising discretionary authority to commit the client, including signing checks on the client’s behalf.

Safeguards:

• Staff providing the assistance should not be given audit responsibility for any function or activity that they performed or supervised during their temporary staff assignment; and
• Obtaining the client’s acknowledgement of its responsibility for directing and supervising the activities of the firm personnel.
Litigation Support or Expert Services

Litigation support services may include such activities as acting as an expert witness, 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 dispute or litigation.

A self-review threat may exist when a member, firm or network firm provides to an audit or review client 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 financial statements.

Safeguards:

• Policies and procedures to prohibit individuals who assist the client from making management decisions on the client’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.
Legal services are defined as any services for which the person providing the services must either be admitted to practice before the Courts of the jurisdiction in which such services are to be provided, or have the required legal training to practice law.

Legal services encompass a wide and diversified range of areas including both corporate and commercial services to clients, such as contract support, litigation, mergers and acquisition advice and support and the provision of assistance to clients' internal legal departments.

Threats to independence need to be considered depending on the nature of the service to be provided, whether the service provider is separate from the assurance team and the materiality of any matter in relation to the entities' financial statements.

Acting for an audit client in the resolution of a dispute or litigation in such circumstances when the amounts involved are material in relation to the financial statements of the audit client would create advocacy and self-review threats so significant no safeguard could reduce the threat to an acceptable level. Therefore, the firm should not perform this type of service for an audit client.
There is a distinction between advocacy and advice. Legal services to support an audit client in the execution of a transaction (e.g., contract support, legal advice, legal due diligence and restructuring) may create self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Such a service would not generally impair independence, provided that following safeguards are in place:

- Using a member of the firm who 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;
- Ensuring the client makes the ultimate decision in relation to the advice provided; and
- Ensuring the service involves the execution of what has been decided by the client in relation to the transaction.
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 firm could generally provide such services as reviewing the professional qualifications of a number of applicants and provide advice on their suitability for the post. In addition, the firm could generally produce a short-list of candidates for interview, provided it has been drawn up using criteria specified by the assurance client.

**Safeguards:**

- Policies and procedures to prohibit members of the firm from making management decisions on behalf of the client; and
- Using members of the firm not part of the engagement team to provide the services.

In all cases, the firm should not make management decisions and the decision as to whom to hire should be left to the client.
The provision of corporate finance services, advice or assistance to an assurance client may create advocacy and self-review threats. In the case of certain corporate finance services, the independence threats created would be so significant no safeguards could be applied to reduce the threats to an acceptable level. For example, promoting, dealing in, or underwriting of an assurance client's shares is not compatible with providing assurance services.

Moreover, committing the assurance client to the terms of a transaction or consummating a transaction on behalf of the client would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level.

In the case of an audit client the provision of those corporate finance services referred to above by a firm or a network firm would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level.
Other corporate finance services may create advocacy or self-review threats; however, safeguards may be available to reduce these threats to an acceptable level.

Examples of such services include assisting a client in developing corporate strategies, 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.

Safeguards that should be considered include:

- Policies and procedures to prohibit individuals assisting the assurance client from making managerial decisions on behalf of the client;
- Using professionals who are not members of the assurance team to provide the services; and
- Ensuring the firm does not commit the assurance client to the terms of any transaction or consummate a transaction on behalf of the client.
Questions?

Floor Discussion
Disclaimer

This presentation is for General Information only, and therefore, should not be substituted for expert opinion. Comments/opinions expressed by the Presenter is his own and not necessarily reflecting the view of the Firm.