What is Auditor Independence?

Auditors are expected to provide an unbiased and professional opinion on the work that they audit. An auditor who lacks independence virtually renders their accompanying auditor report useless to those who rely on them.

For example, consider yourself a potential investor in ABC Company. If you know that the auditor for ABC Company keeps a personal relationship with the CEO of the company, would you trust that the audited work is a fair representation of the company's financial standing? How can you be certain that the auditor and CEO did not collude to issue a favourable audit report?

The fact is auditors who lack independence compromises the integrity of financial markets and the reliability of information. Investors would not be willing to extend capital to other companies knowing that the audited information was performed by an auditor who is not independent. Furthermore, banks would not be willing to issue a loan for fear that the auditor might've provided a biased audit report.

THREATS TO OBJECTIVITY/INDEPENDENCE

The following are all examples of behaviour that could threaten the practitioner's objectivity or independence from their clients:

1. **Self-interest threat**

This occurs when an auditor has a beneficial interest in a client's performance. Examples include:When the auditor or a member of their family owns shares in a client. They would directly benefit from increases in client profits and would be reluctant to raise any concerns that could adversely affect the performance of the client.When a firm is dependent upon one client for a significant proportion of their total fee income. The firm may not raise issues with the client for fear of losing them.The acceptance of gifts and hospitality. This could be perceived as bribery to keep quiet about issues in the financial statements

Also Self-interest threat occurs as a result of the financial or other interests of a professional accountant or of an immediate or close family member;

Self Interest Threats Circumstances

— A financial interest in a client or jointly holding a financial interest with a client.

— Having a close business relationship with a client.

— Concern about the possibility of losing a client.

— Potential employment with a client.

— Contingent fees relating to an engagement.

— A loan to or from a client or any of its directors or officers.

2. Self-review threat

This occurs when an auditor has to review work that he or she previously performed. For example: if the external auditor prepared the financial statements and then audited them. There is a risk that the auditor would not identify any shortcomings in their own work.

Also self-Review Threat occurs occur when a previous judgment needs to be re-evaluated by the professional accountant responsible for that judgment.

Self-Review Threat Circumstances

— The discovery of a significant error during a re-evaluation of the work of the auditor.

— Reporting on the operation of financial systems after being involved in their design or implementation.

— Having prepared the original data used to generate records that are the subject matter of the engagement.

— A member of the team being, or having recently been, a director or officer of that client.

— A member of the team being, or having recently been, employed by the client in a position to exert direct and significant influence over the subject matter of the engagement.

— Performing a service for a client that directly affects the subject matter of the engagement.

3. Advocacy threat

This can occur when the auditor is asked to promote or represent their client in some way. In this situation the auditor would have to be biased in favour of the client and therefore cannot be objective. This could happen if the client asked the auditor to promote their shares for a stock exchange listing or if the client asked the auditor to represent them in court.

4. Familiarity threat

This occurs when the auditor is too sympathetic or trusting of the client because of a close relationship with them. This may be because a close friend or relative of the auditor works in a key role for the client. The auditor may trust their friend or relative to not make mistakes and therefore not review their work as thoroughly as they should and as a result allow material errors to go undetected in the financial statements. This can also arise after a long association with a client.

Familiarity Threat also occurs when, by virtue of a close relationship with a client, its directors, officers or employees, an auditor becomes too sympathetic to the client's interests.

Familiarity Threat Circumstances

- Immediate family member or close family member who is a director, officer, or influential employee of the client;
- A member of the team having a close family member who, as an employee of the client, is in a position to exert direct and significant influence over the subject matter of the engagement;
- A former partner of the firm being a director, officer of the client or an employee in a position of significant influence;
- Long association of a senior member of the team with the client
- Acceptance of gifts or hospitality, unless the value is clearly insignificant, from the client, its directors, officers or employees.

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kutishwa
kwama woga wahali yajamaan

5. Intimidation threat timido

Clients may try to harass or bully auditors into giving preferential audit reports. They may use the fee as leverage. The auditor should not give in to such pressure and, in the circumstances, may choose to resign from such a client.

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QUESTION ONE

You are an audit senior in the Gift audit firm and have been allocated to the audit of Bupe Kamba & Co. (Bupe), for the financial statements ending 30th June 2017. Bupe has been an audit client of Gift CPAs for eight years and specialises in manufacturing musical instruments.

Walii Shabani (Walii) who had been the audit engagement partner for Bupe for the last seven years has recently been rotated off the audit engagement. The current audit partner, Nuru Mkoronzi, has suggested that in order to maintain a close relationship with Bupe, Walii should undertake the role of independent review partner this year. In addition Bupe has requested that Walii assist them by attending their BOD meetings, because Bupes's non-executive director has recently left the company.

Bupe has also asked Nuru and the other partners at Gift CPAs to help them in recruiting a new non-executive director.

The total fees received by Gift CPAs for last year equated to 16% of the firm's total fee income. The current year's audit fee has not yet been confirmed, but along with taxation and other possible non-audit fees the total income from Bupe this year could be greater than the amount paid last year. Last year's audit fee was being paid monthly by Bupe but no payments have been made for the last three months.

Fredy Ngowi, the audit manager for Bupe has just announced that he is leaving Gift CPAs to join Bupe& Co. as the financial controller. Fredy is the one who prepared the audit plans that is currently being used in auditing Bupe & Co

Required:

Using the information above:

(i) Identify and explain FIVE ethical threats which may affect the independence of Gift CPAs in the audit of Bupe Kamba & Co. **(10 marks)**

(ii) For each threat explain how it might be reduced to an acceptable level. **(5 marks)**

(Total 15 Marks)

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SOLUTION ONE

	(i) Ethical threat	(ii) Managing these risks
1	Walii Shabani (Walii) was the audit engagement partner of Bupe Kamba& Co (Bupe) for the last seven years and has recently rotated off the audit. It has been proposed that he should now become the independent review partner. This represents a ***familiarity threat*** as Walii, the review partner will have been associated with Bupe for a long period of time and so may not retain professional scepticism and objectivity.	As Bupe is a listed company, then Walii Shabani should not serve as the independent review partner for a period of two years. An alternative review partner should be appointed instead
2	Bupe has requested the previous engagement partner, Walii, attend BOD meetings as a non-executive director of Bupe has recently left. This represents a ***self-interest*** threat as the Gift audit firm may be perceived as performing the role of management by attending these meetings and this threatens objectivity.	The firm should politely decline this request from Bupe, as it represents too great a threat to independence
3	*A non-executive director of Bupe has recently left and Bupe have asked whether the partners of Gift CPAs can assist them in recruiting to fill this vacancy.* *This represents a **self-interest threat** as the audit firm cannot undertake the recruitment of senior management of Bupe, especially as non-executive directors have a key responsibility in appointing the audit firm.*	Gift CPAs is able to assist Bupe in that they can undertake roles such as reviewing a shortlist of candidates. However, they must ensure that they are not seen to undertake management decisions and so must not make the final decision on who is appointed

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4	The total fees received from Bupe for last year equated to 16% of the firm's total income. The fees for this year have not been finalised, but it is anticipated that they could be greater than 16%. There is a potential ***self-interest threat*** as the total fees could represent a significant proportion of Gift CPAs income. Bupe.	Gift CPAs should assess whether audit and non-audit fees would represent more than 15% of gross practice income for two consecutive years. If the recurring fees are likely to exceed 15% of annual practice income this year, additional consideration should be given as to whether the taxation and non-audit assignments should be undertaken by the firm. In addition, if the fees do exceed 15% then this should be disclosed to those charged with governance at
5	Last year's audit fee was being paid monthly, however, the last three months' payments are outstanding. ***A self-interest threat*** can arise if the fees remain outstanding, as Gift CPAs may feel pressure to agree to certain accounting adjustments in order to have the previous year and this year's audit fee paid. In addition, outstanding fees could be perceived as a loan to a client which is strictly prohibited.	Gift CPAs should discuss with those charged with governance the reasons why the last three months' payments have not been made. They should agree a revised payment schedule which will result in the fees being settled before much more work is performed for the current year audit
6	The audit manager of Bupe is leaving Gift CPAs to become the financial controller at Bupe. This represents a ***self-interest*** and ***familiarity threat*** as the audit manager is familiar with theaudit plan which is to be adopted at Bupe and he may also have commenced work on this year's audit.	A new audit manager should be appointed to Bupe and any work already undertaken by Fredy Ngowi, the previous manager should be independently reviewed. In addition, it would be advisable to modify the audit plan so that the manage would not be overly familiar with the approach to be adopted.

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QUESTION TWO

You are an audit manager of Samamba Partners & Co (Samamba) and are planning the audit of Puma Finance Co (Puma), a banking institution which provides a range of financial services including loans. Your firm has audited Puma for four years and the company's year-end is 30 June 2017.

At the end of May, Puma's chief finance officer (CFO) left and the new replacement is not due to start until approximately two months after the year end. The chief executive officer (CEO) Sarah Kilimba, who is the sister-in-law (wifi) of the audit engagement partner Amina Galawa, has asked if a member of the audit team can be seconded to Puma for three months to act as the temporary CFO.

of Samamba

You are aware that a number of the audit team members currently bank with Puma and two team members have significant loans owing to the company. Samamba's taxation department also provides services to Puma. They have been approached by Puma to represent them in negotiations to resolve some outstanding issues with the taxation authorities, for which the fees quoted are substantial.

The CEO, Sarah Kilimba has informed the audit engagement partner that when the audit is complete, she would like the whole team to attend an evening watching the national football team play a match followed by a luxury meal.

Required:

Using the information above:

(a) Identify and explain FIVE ethical threats which may affect the independence of Samamba Partners & Co's audit of Puma Finance Co; and **(15 marks)**

(b) For each threat, explain how it might be reduced to an acceptable level. **(5 marks)**

(Total 20 marks)

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SOLUTION TWO

	Threat to Auditor Independence	Ways to Mitigate Threat
1	The chief executive officer (CEO) is the sister-in-law of the audit engagement partner and hence there is a family relationship. There is a *familiarity and self-interest threat* as the audit partner and the CEO both hold senior positions and therefore are in a position to influence the outcome of the audit. There is a concern that they may place their family relationship above the needs of the users of the financial statements.	Although the family relationship is only established by marriage, as it is a sister-in-law, it would be advisable for the audit engagement partner to be removed and an alternative partner appointed It is likely that as the CFO, the member of the engagement team will be directly involved with items related to financial statements. As such, the request from the CEO should be declined, or the team member should be removed from the audit of Puma.
2	Puma CEO has asked if a member of the audit team can be seconded to fill the role of chief finance officer (CFO). *A self-review risk* arises if the team member prepares records and schedules which support the financial statements and is then part of the audit team responsible for auditing these. Two members of the audit team have significant loans owing to the company. Puma is a banking institution and hence the provision of a loan is within the normal course of business. However, if either of the loans has any preferential terms, such as rates or repayment periods, then this would represent *a self-interest threat.*	The terms of the loans should be reviewed to ascertain whether they are in any way preferential. If not, no further action is required. However, if the terms are preferential then either the terms should be amended or these two members should be removed from the audit team.

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3	Puma has requested that Samamba's taxation department represents them in negotiations to resolve some outstanding issues with the taxation authorities. There is a potential advocacy threat where the firm may promote an opinion on behalf of Puma, such that the independence of the firm is compromised. In addition, the outcome of these issues may have a material impact on the financial statements, resulting in *a self-review threat.*	Due to the likelihood of these issues having a material impact on the financial statements and the advocacy threat, it is advisable that the firm politely declines this request. Samamba should assess whether audit, non-audit and total taxation fees would represent a significant proportion of recurring fee income.
4	The taxation fees being quoted to Puma are substantial. There is a potential *self-interest threat* as the total fees could represent a significant proportion of Samamba's income and the firm could become overly reliant on Puma	If the recurring fees are likely to be significant, additional consideration should be given as to whether the taxation and/or non-audit assignments should be undertaken by the firm.
5	The CEO has invited the whole team to attend an evening out watching the national football match followed by a luxury meal. This represents *a self-interest* and familiarity threat as the acceptance of goods and services, unless insignificant in value, is not permitted	As it is unlikely the football tickets and luxury meal for the whole team has an insignificant value, then this offer sh be politely declined

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3	Puma has requested that Samamba's taxation department represents them in negotiations to resolve some outstanding issues with the taxation authorities. There is a potential advocacy threat where the firm may promote an opinion on behalf of Puma, such that the independence of the firm is compromised. In addition, the outcome of these issues may have a material impact on the financial statements, resulting in *a self-review threat.*	Due to the likelihood of these issues having a material impact on the financial statements and the advocacy threat, it is advisable that the firm politely declines this request. Samamba should assess whether audit, non-audit and total taxation fees would represent a significant proportion of recurring fee income.
4	The taxation fees being quoted to Puma are substantial. There is a potential *self-interest threat* as the total fees could represent a significant proportion of Samamba's income and the firm could become overly reliant on Puma	If the recurring fees are likely to be significant, additional consideration should be given as to whether the taxation and/or non-audit assignments should be undertaken by the firm.
5	The CEO has invited the whole team to attend an evening out watching the national football match followed by a luxury meal. This represents *a self-interest* and familiarity threat as the acceptance of goods and services, unless insignificant in value, is not permitted	As it is unlikely the football tickets and luxury meal for the whole team has an insignificant value, then this offer should be politely declined

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QUESTION THREE

You are an audit manager in JM & Co, a firm of Certified Public Accountants. You are preparing the engagement letter for the audit of Rahma, a public limited liability company (PLC), for the year ending 30 June 2015. Rahma PLC has grown rapidly over the past few years, and is now one of your firm's most important clients.

Rahma PLC has been an *audit client for eight years* (familiarity threat) and JM & Co has provided audit, taxation and management consultancy advice during this time – *provision of others services.* The client has been satisfied with the services provided, although the taxation fee for the period to 30 June 2014 *remains unpaid.* – Overdue fees

Audit personnel available for this year's audit are most of the staff from last year, including Mr Kijanga, an audit partner and Mr Munna, an audit senior. Mr Kijanga has been the audit partner since Rahma PLC became an audit client. – Familiarity threat

You are aware that Balima Kijanga, the daughter of Mr Kijanga, has recently been appointed the financial director at Rahma PLC. To celebrate her new appointment, Balima has suggested taking all of the audit staff out to an *expensive restaurant* prior to the start of the audit work for this year. *Hospitality- value should be modest*

Required:

Identify and explain the risks to independence arising in carrying out your audit of Rahma PLC for the year ending 30 June 2015, and suggest ways of mitigating each of the risks you identify.

(15 marks)

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SOLUTION THREE

1 Threat to Independence

Unpaid taxation fees- non-payment of taxation fees is a threat to objectivity and it tantamount to an unpaid loan. If the need arise to issue a modified report, the auditor will hesitate because of the fear that the client leaves him and the fees remains unpaid.

Mitigation (Solution) - Consider delaying start of audit till fees are paid. If fee is not settled, decline assignment to carry the audit.

2 Threat to Independence

Audit partner-*time in office for 8 years*- objectivity for the audit may be threatened by the ongoing close relationship with the client i.e. too friendly with directors of Rahma PLC. May put the audit partner in a position where he won't be able to take independent decision like qualifying report (if need arise) because of his friendship.

Mitigation (Solution): To rotate audit partner

3 Threat to Independence

Relationship: Balima Kijanga is not deemed to be connected to Mr Kijanga because she is presumably over 18years of age. If still a minor, then it is inappropriate for Mr Kijanga to be audit partner as he would influence Balima decision. But still independence is not total (appear to general public that independence is impaired.) as he may hesitate to annoy his daughter by qualifying the audit report.

Mitigation (Solution)- Recommended to appoint another audit partner so that the audit is seen to be independent

4 Threat to Independence

Meal: Expensive meal affects independence as staff of audit team may be too friendly with Balima. Modest gifts are allowed but not expensive one. .

Mitigation (Solution)-To decline invitation

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QUESTION FOUR

You are the audit manager of Najma Ally & Co (Najma Ally) and you are planning the audit of Golden Finances Co (Golden), who specialise in the provision of loans and financial advice to individuals and companies. Najma Ally has audited Golden for many years.

The directors are planning to list Golden on a stock exchange within the next few months and have asked if the engagement partner can attend the meetings with potential investors. In addition, as the finance director of Golden is likely to be quite busy with the listing, he has asked if Najma Ally can produce the financial statements for the current year.

During the year, the assistant finance director of Golden left and joined Najma Ally as a partner. It has been suggested that due to his familiarity with Golden, he should be appointed to provide an independent partner review for the audit.

Once Golden obtains its stock exchange listing it will require several assignments to be undertaken, for example, obtaining advice about corporate governance best practice. Najma Ally is very keen to be appointed to these engagements, however, Golden has implied that in order to gain this work Najma Ally needs to complete the external audit quickly and with minimal questions/issues.

The finance director has informed you that once the stock exchange listing has been completed, he would like the engagement team to attend a weekend away at a luxury hotel with his team, as a thank you for all their hard work.

In addition, he has offered a senior member of the engagement team a short-term loan at a significantly reduced interest rate.

Required:

(i) Explain SIX ethical threats which may affect the independence of Najma Ally's audit of GoldenFinances Co; and

(ii) For each threat explain how it might be reduced to an acceptable level. (12 marks)

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SOLUTION FOUR

Ethical threats and managing these risks

12	ethical threat	managing risk
	Golden Finances co (Golden) has asked the engagement partner of Najma Ally to attend meetings with potential investors. this represents an *advocacy threat* as the audit firm may be perceived as promoting investment in Golden	the engagement partner should politely decline this request from Golden, as it represents too great a threat to independence
	Due to the stock exchange listing, Golden has requested that Najma Ally produce the financial statements. This represents a *self-review* threat as Golden is currently not a listed company then Najma Ally are permitted to produce the financial statements and also audit them. But, Golden is seeking a listing and thus these financial statements will be critical to the potential investors and this increases audit risk.	Ideally, Najma Ally should not undertake the preparation of the financial statements. Due to the imminent listing, this would probably represent too high a risk. If Najma Ally choose to produce the financial statements then separate teams should undertake each assignment and the audit team should not be part of the accounts preparation process.
	Golden has several potential assurance assignments available and Najma Ally wish to be appointed to these assignments. There is a potential *self-interest* threat as these assurance fees along with the external audit fee could represent a significant proportion of Najma Ally's fee income.	The firm should assess whether these assignments along with the audit fee would represent more than 15% of gross practice income for two consecutive years. These assurance assignments will only arise if the company obtains its listing and hence will be a public interest company. If the recurring fees are likely to exceed 15% of annual practice income then additional consideration should be

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with the name and presence of ALLAH we can !!!!

	given as to whether these assignments should be sought by the firm.
Golden has implied to Najma Ally that they must complete the audit quickly and with minimal questions/ issues if they wish to obtain the assurance assignments. This creates an *intimidation threat* on the team as they may feel pressure to cut corners and not raise issues, and this could compromise the objectivity of the audit team.	The engagement partner should politely inform the finance director that the team will undertake the audit in accordance with all relevant ISAs and their own quality control procedures. This means that the audit will take as long as is necessary to obtain sufficient, appropriate evidence to form an opinion. if any residual concerns remain or the intimidation threat continues then Najma Ally may need to considering resigning from the engagement
The finance director has offered the team a free weekend away at a luxury hotel. This represents a *self-interest* threat as the acceptance of goods and services, unless insignificant in value, is not permitted.	As it is unlikely that a weekend at a luxury hotel for the whole team has an insignificant value, then this offer should be politely declined.
The finance director has offered a senior team member a loan at discounted interest rates. Golden does provide loans and hence the provision of a loan is within the normal course of business. However, if the loan is on preferential rates, as this is, then it would represent a *self-interest threat*.	this loan must not be accepted by the audit senior due to the preferential terms However, if the terms of the loan are amended so that the interest rate charged is in line with Golden's normal levels, then the provision of the loan is acceptable.

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