



Audit Quality Assurance Workshop Mt. Kenya Branch

Theme: Embracing International Auditing Standards in Carrying Out
Audit Engagements

Ethics & Governance for auditors

Friday 24th March 2017

Contents:

1. Background
2. Why is ethics important
3. General application of the code of ethics (Part A)
4. Guidance for professional accountants in practice (Part B)
5. Independence requirements
6. Guidance for professional accountants in business (Part C)

Background:

The International Ethics Standards Board for Accountants (IESBA) is an independent standard-setting body that develops an internationally appropriate *Code of Ethics for Professional Accountants*, (the Code).

- The handbook of the code of ethics for professional accountants, 2016 outlines the **ethical requirements for professional accountants in practice or in business**.
- The Ethics Code contains three parts. Part A establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework that professional accountants shall apply to:
 - (a) Identify threats to compliance with the fundamental principles;
 - (b) Evaluate the significance of the threats identified; and
 - (c) Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level.

Parts B and C describe **how the conceptual framework applies in certain situations**. They provide examples of safeguards that may be appropriate to address threats to compliance with the fundamental principles.

Importance of compliance with Ethics Code.

DISCUSSION:

- (i) PKF & Imperial Bank
- (ii) Deloitte & Chase Bank
- (iii) Jonathan Ciano in Uchumi
- (iv) EY & Uchumi
- (v) Discount Securities & Nyaga & Associates
- (vi) Deloitte & Mumias
- (vii) Deloitte & CMC motors
- (viii) The Nairobi County- CFO
- (ix) The NYS Scandal

General application of the code

Fundamental Principles:

A professional accountant shall comply with the following fundamental principles:

- **Integrity** – to be straightforward and honest in all professional and business relationships.
- **Objectivity** – to not allow bias, conflict of interest or undue influence of others to override professional or business judgments.
- **Professional Competence and Due Care** – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.
- **Confidentiality** – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.
- **Professional Behavior** – to comply with relevant laws and regulations and avoid any action that discredits the profession.

General application of the code. Cont...

Threats to compliance with the code:

- When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant's compliance with the fundamental principles. Threats fall into the below categories:
- **Self-interest threat** – the threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior;
- **Self-review threat** – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made, or activity or service performed by the professional accountant, or by another individual within the professional accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity or providing a current service;
- **Advocacy threat** – the threat that a professional accountant will promote a client's or employer's position to the point that the professional accountant's objectivity is compromised;
- **Familiarity threat** – the threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- **Intimidation threat** – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant.

General application of the code.

Cont...

Safeguards

These are actions or other measures that may eliminate threats or reduce them to an acceptable level. They fall into two broad categories:

- Safeguards created by the profession, legislation or regulation; and
- Safeguards in the work environment.

General application of the code.

Cont...

Safeguards..Cont.

Safeguards created by the profession, legislation or regulation include:

- Educational, training and experience requirements for entry into the profession.
- Continuing professional development requirements.
- Corporate governance regulations.
- Professional standards.
- Professional or regulatory monitoring and disciplinary procedures.
- External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.

Professional Accountant in Public Practice (Part B)

Examples of Self Interest Threats:

- A member of the assurance team having a direct financial interest in the assurance client.
- A firm having undue dependence on total fees from a client.
- A member of the assurance team having a significant close business relationship with an assurance client.
- A firm being concerned about the possibility of losing a significant client.
- A member of the audit team entering into employment negotiations with the audit client.
- A firm entering into a contingent fee arrangement relating to an assurance engagement.
- A professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the professional accountant's firm.

Professional Accountant in Public Practice (Part B)..Cont..

Examples of circumstances that create self-review threats

- A firm issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.
- A firm having prepared the original data used to generate records that are the subject matter of the assurance engagement.
- A member of the assurance team being, or having recently been, a director or officer of the client.
- A member of the assurance team being, or having recently been, employed by the client in a position to exert significant influence over the subject matter of the engagement.
- The firm performing a service for an assurance client that directly affects the subject matter information of the assurance engagement.

Professional Accountant in Public Practice (Part B)..Cont..

Examples of circumstances that create advocacy threats include:

- The firm promoting shares in an audit client.
- A professional accountant acting as an advocate on behalf of an audit client in litigation or disputes with third parties.

Professional Accountant in Public Practice (Part B)..Cont..

Examples of circumstances that create familiarity threats:

- A member of the engagement team having a close or immediate family member who is a director or officer of the client.
- A member of the engagement team having a close or immediate family member who is an employee of the client who is in a position to exert significant influence over the subject matter of the engagement.
- A director or officer of the client or an employee in a position to exert significant influence over the subject matter of the engagement having recently served as the engagement partner.
- A professional accountant accepting gifts or preferential treatment from a client, unless the value is trivial or inconsequential.
- Senior personnel having a long association with the assurance client.

Professional Accountant in Public Practice (Part B)..Cont..

Examples of circumstances that create intimidation threats:

- A firm being threatened with dismissal from a client engagement.
- An audit client indicating that it will not award a planned non-assurance contract to the firm if the firm continues to disagree with the client's accounting treatment for a particular transaction.
- A firm being threatened with litigation by the client.
- A firm being pressured to reduce inappropriately the extent of work performed in order to reduce fees.
- A professional accountant feeling pressured to agree with the judgment of a client employee because the employee has more expertise on the matter in question.
- A professional accountant being informed by a partner of the firm that a planned promotion will not occur unless the accountant agrees with an audit client's inappropriate accounting treatment.

Professional Accountant in Public Practice (Part B)..Cont..

Examples of firm-wide safeguards in the work environment include:

- Leadership of the firm that stresses the importance of compliance with the fundamental principles.
- Leadership of the firm that establishes the expectation that members of an assurance team will act in the public interest.
- Policies and procedures to implement and monitor quality control of engagements.
- Documented policies regarding the need to identify threats to compliance with the fundamental principles, evaluate the significance of those threats, and apply safeguards to eliminate or reduce the threats to an acceptable level or, when appropriate safeguards are not available or cannot be applied, terminate or decline the relevant engagement.

Professional Accountant in Public Practice (Part B)..Cont..

Examples of engagement-specific safeguards in the work environment include:

- Having a professional accountant who was not involved with the non-assurance service review the non-assurance work performed or otherwise advise as necessary.
- Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary.
- Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- Discussing ethical issues with those charged with governance of the client.
- Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
- Involving another firm to perform or re-perform part of the engagement.
- Rotating senior assurance team personnel

Professional Accountant in Public Practice (Part B)..Cont..

A professional accountant in public practice may also be able to rely on safeguards that the client has implemented. However it is not possible to rely solely on such safeguards to reduce threats to an acceptable level.

Examples of safeguards within the client's systems and procedures include:

- The client requires persons other than management to ratify or approve the appointment of a firm to perform an engagement.
- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that ensure objective choices in commissioning non-assurance engagements.
- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

Auditor Independence in Audit & Review Engagements.

In the case of audit engagements, it is in the public interest and, therefore, required by this Code, that members of audit teams, firms and network firms shall be independent of audit clients.

Independence comprises:

i. Independence of Mind

- The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

ii. Independence in Appearance

- The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit team's, integrity, objectivity or professional skepticism has been compromised.

Auditor Independence in Audit & Review Engagements. Cont...

Threats to independence:

(i) Financial Interest

Holding a financial interest in an audit client may create a self-interest threat. The existence and significance of any threat created depends on:

- The role of the person holding the financial interest,
- Whether the financial interest is direct or indirect, and
- The materiality of the financial interest.

If a member of the audit team, a member of that individual's immediate family, or a firm has a direct financial interest or a material indirect financial interest in the audit client, the self-interest threat created would be so significant that no safeguards could reduce the threat to an acceptable level.

The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Removing the member of the audit team with the financial interest from the audit team; or
- Having a professional accountant review the work of the member of the audit team

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(ii) Loans and Guarantees:

A loan, or a guarantee of a loan, to a member of the audit team, or a member of that individual's immediate family, or the firm from an audit client that is a bank or a similar institution may create a threat to independence. If the loan or guarantee is not made under normal lending procedures, terms and conditions, a self-interest threat would be created that would be so significant that no safeguards could reduce the threat to an acceptable level.

Accordingly, neither a member of the audit team, a member of that individual's immediate family, nor a firm shall accept such a loan or guarantee.

A loan, or a guarantee of a loan, from an audit client that is a bank or a similar institution to a member of the audit team, or a member of that individual's immediate family, does not create a threat to independence if the loan or guarantee is made under normal lending procedures, terms and conditions.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(iii) Business Relationships:

A close business relationship between a firm, or a member of the audit team, or a member of that individual's immediate family, and the audit client or its management, arises from a commercial relationship or common financial interest and may create self-interest or intimidation threats.

Examples of such relationships include:

- Having a **financial interest in a joint venture** with either the client or a controlling owner, director, officer or other individual who performs senior managerial activities for that client.
- Arrangements to combine one or more services or products of the firm with one or more services or products of the client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm distributes or markets the client's products or services, or the client distributes or markets the firm's products or services.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(iv) Family and Personal Relationships

Family and personal relationships between a member of the audit team and a director or officer or certain employees (depending on their role) of the audit client may create self-interest, familiarity or intimidation threats. The existence and significance of any threats will depend on a number of factors, including the individual's responsibilities on the audit team, the role of the family member or other individual within the client and the closeness of the relationship.

When an immediate family member of a member of the audit team is:

- a director or officer of the audit client; or
- an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion,
- or was in such a position during any period covered by the engagement or the financial statements, the threats to independence can only be reduced to an acceptable level by removing the individual from the audit team.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(vi) Recent Service with an Audit Client

- Self-interest, self-review or familiarity threats may be created if a member of the audit team has recently served as a director, officer, or employee of the audit client. This would be the case when, for example, a member of the audit team has to evaluate elements of the financial statements for which the member of the audit team had prepared the accounting records while with the client.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(vii) Long Association of Senior Personnel (Including Partner Rotation) with an Audit Client

Familiarity and self-interest threats are created by using the same senior personnel on an audit engagement over a long period of time. The significance of the threats will depend on factors such as:

- How long the individual has been a member of the audit team;
- The role of the individual on the audit team;
- The structure of the firm;
- The nature of the audit engagement;
- Whether the client's management team has changed; and
- Whether the nature or complexity of the client's accounting and reporting issues has changed.

Examples of safeguards include: Rotating the senior personnel off the audit team; Having a professional accountant who was not a member of the audit team review the work of the senior personnel; or Regular independent internal or external quality reviews of the engagement.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(ix) Provision of Non-assurance Services to an Audit Client

Firms have traditionally provided to their audit clients a range of non-assurance services that are consistent with their skills and expertise.

Providing non-assurance services may, however, create threats to the independence of the firm or members of the audit team. The threats created are most often self-review, self-interest and advocacy threats.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(x) Management Responsibilities:

Management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.

Examples of activities that would be considered a management responsibility include:

- i. Setting policies and strategic direction.
- ii. Hiring or dismissing employees.
- iii. Directing and taking responsibility for the actions of employees in relation to the employees' work for the entity.
- iv. Authorizing transactions.
- v. Controlling or managing of bank accounts or investments.
- vi. Deciding which recommendations of the firm or other third parties to implement.
- vii. Reporting to those charged with governance on behalf of management.
- viii. Taking responsibility for the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework.
- ix. Taking responsibility for designing, implementing, monitoring or maintaining internal controls.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(x) Management Responsibilities Cont..:

A firm shall not assume a management responsibility for an audit client. The threats created would be so significant that no safeguards could reduce the threats to an acceptable level.

For example, deciding which recommendations of the firm to implement will create self-review and self-interest threats. Further, assuming a management responsibility creates a familiarity threat because the firm becomes too closely aligned with the views and interests of management.

Providing an audit client with accounting and bookkeeping services, such as preparing accounting records or financial statements, creates a self-review threat when the firm subsequently audits the financial statements.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(x) Management Responsibilities. Cont..

The firm may provide services related to the preparation of accounting records and financial statements to an audit client that is not a public interest entity where the services are of a routine or mechanical nature, so long as any self-review threat created is reduced to an acceptable level. Services that are routine or mechanical in nature require little to no professional judgment from the professional accountant. Some examples of such services are:

- i. Preparing payroll calculations or reports based on client-originated data for approval and payment by the client.
- ii. Recording recurring transactions for which amounts are easily determinable from source documents or originating data, such as a utility bill where the client has determined or approved the appropriate account classification.
- iii. Recording a transaction for which the client has already determined the amount to be recorded, even though the transaction involves a significant degree of subjectivity.
- iv. Calculating depreciation on fixed assets when the client determines the accounting policy and estimates of useful life and residual values.
- v. Posting client-approved entries to the trial balance.
- vi. Preparing financial statements based on information in the client-approved trial balance and preparing the related notes based on client-approved records.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(xi) Tax Return Preparation

- Tax return preparation services involve assisting clients with their tax reporting obligations by drafting and completing information, including the amount of tax due.
- Tax return preparation services are generally based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice.
- Further, the tax returns are subject to whatever review or approval process the tax authority deems appropriate. Accordingly, **providing such services does not generally create a threat to independence if management takes responsibility for the returns** including any significant judgments made

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(xii) Fees

- *Fees—Relative Size*; - When the total fees from an audit client represent a large proportion of the total fees of the firm expressing the audit opinion, the dependence on that client and concern about losing the client creates a self-interest or intimidation threat.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(xii) Fees. Cont...

The significance of the threat will depend on factors such as:

- The operating structure of the firm;
- Whether the firm is well established or new; and
- The significance of the client qualitatively and/or quantitatively to the firm.

The significance of the threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Reducing the dependency on the client;
- External quality control reviews

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(xiii) Compensation and Evaluation Policies

A self-interest threat is created when a member of the audit team is evaluated on or compensated for selling non-assurance services to that audit client.

The significance of the threat will depend on the proportion of the individual's compensation or performance evaluation that is based on the sale of such services; the role of the individual on the audit team; and whether promotion decisions are influenced by the sale of such services.

The firm shall either revise the compensation plan or evaluation process for that individual or apply safeguards to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Removing such members from the audit team; or
- Having a professional accountant review the work of the member of the audit team.

Auditor Independence in Audit & Review Engagements. Cont..

Threats to independence. Cont....

(xiv) Gifts and Hospitality

Accepting gifts or hospitality from an audit client may create **self-interest and familiarity threats**. If a firm or a member of the audit team accepts gifts or hospitality, unless the value is trivial and inconsequential, the threats created would be so significant that no safeguards could reduce the threats to an acceptable level. Consequently, a firm or a member of the audit team shall not accept such gifts or hospitality.

Auditor Independence in Audit & Review Engagements. Cont..

(xv) Actual or Threatened Litigation

- When litigation takes place, or appears likely, between the firm or a member of the audit team and the audit client, self-interest and intimidation threats are created.
- If the litigation involves a member of the audit team, removing that individual from the audit team

Auditor Independence in Audit & Review Engagements. Cont..

Documentation of compliance with Independence requirement.

- Documentation provides **evidence** of the professional accountant's judgments in forming conclusions regarding compliance with independence requirements.
- The professional accountant **shall document conclusions regarding compliance with independence requirements**, and the substance of any relevant discussions that support those conclusions.
- When **safeguards** are required to reduce a threat to an acceptable level, the professional accountant **shall document the nature of the threat and the safeguards in place or applied** that reduce the threat to an acceptable level

Professional Accountant in Business (Part C).

A professional accountant in business may be a salaried employee, a partner, director (whether executive or non-executive), an owner manager, a volunteer or another working for one or more employing organization.

A professional accountant in business has a responsibility to further the legitimate aims of the accountant's employing organization.

This Code does not seek to hinder a professional accountant in business from properly fulfilling that responsibility, but addresses circumstances in which compliance with the fundamental principles may be compromised

Professional Accountant in Business (Part C).

Threats to compliance with code:

Examples of self-interest threats for a professional accountant in business include:

- Holding a **financial interest** in, or receiving a loan or guarantee from the employing organization.
- Participating in **incentive compensation** arrangements offered by the employing organization.
- Inappropriate **personal use of corporate assets**.
- Concern over **employment security**.
- Commercial **pressure from outside the employing organization**.

Professional Accountant in Business (Part C).

Threats to compliance with code. Cont..:

An example of a circumstance that creates a self-review threat for a professional accountant in business is **determining the appropriate accounting treatment for a business combination after performing the feasibility study** that supported the acquisition decision.

When furthering the legitimate goals and objectives of their employing organizations, professional accountants in business may promote the organization's position, provided **any statements made are neither false nor misleading**. Such actions generally would not create an advocacy threat.

Professional Accountant in Business (Part C).

Examples of circumstances that may create familiarity threats for a professional accountant in business include:

- Being responsible for the employing organization's financial reporting when an immediate or close family member employed by the entity makes decisions that affect the entity's financial reporting.
- Long association with business contacts influencing business decisions.
- Accepting a gift or preferential treatment, unless the value is trivial and inconsequential.

Professional Accountant in Business (Part C).

Examples of circumstances that may create intimidation threats for a professional accountant in business include:

- Threat of dismissal or replacement of the professional accountant in business or a close or immediate family member over a disagreement about the application of an accounting principle or the way in which financial information is to be reported.
- A dominant personality attempting to influence the decision making process, for example with regard to the awarding of contracts or the application of an accounting principle.

Professional Accountant in Business (Part C).

Safeguards in the work environment include:

- The employing organization's **systems of corporate oversight** or other oversight structures.
- The employing organization's **ethics and conduct programs**.
- **Recruitment procedures** in the employing organization emphasizing the importance of employing high caliber competent staff.
- Strong internal controls.
- Appropriate **disciplinary processes**.
- Leadership that stresses the importance of ethical behavior and the expectation that employees will act in an ethical manner.
- Policies and procedures to implement and monitor the quality of employee performance.
- **Timely communication of the employing organization's policies and procedures**, including any changes to them, to all employees and appropriate training and education on such policies and procedures.
- Policies and procedures to empower and encourage employees to communicate to senior levels within the employing organization any ethical issues that concern them without fear of retribution.
- Consultation with another appropriate professional accountant.

Interactive Session





Presenter's Contacts



CPA Cyprian Oluoch

Cyprian.angawa@bukasconsultancy.com

Cangawa@gmail.com

Mobile No. 0724-665391